S. HRG. 107–534

FHA MULTIFAMILY HOUSING MORTGAGE INSURANCE PROGRAM

HEARING

BEFORE THE

SUBCOMMITTEE ON HOUSING AND TRANSPORTATION

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

ON

THE EXAMINATION OF THE FEDERAL HOUSING ADMINISTRATION MULTIFAMILY HOUSING MORTGAGE INSURANCE PROGRAM, FOCUSING ON THE IMPENDING INCREASE IN MORTGAGE INSURANCE PREMIUMS, PROGRAM CREDIT SUBSIDY RATES, AND THE ADMINISTRATION'S PROPOSED INCREASE IN THE PER-UNIT MORTGAGE LOAN LIMITS

JULY 24, 2001

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C O N T E N T S

TUESDAY, JULY 24, 2001

WITNESSES

Additional Material Supplied for the Record

FHA MULTIFAMILY HOUSING MORTGAGE INSURANCE PROGRAM

TUESDAY, JULY 24, 2001

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING AND TRANSPORTATION,
Washington, DC.

The Subcommittee met at 2 p.m. in room SD–538 of the Dirksen Senate Office Building, Senator Jack Reed (Chairman of the Subcommittee) presiding.

OPENING STATEMENT OF SENATOR JACK REED

Senator REED. Let me call the hearing to order. Good afternoon. I would like to welcome all of our witnesses and everyone to today's hearing on the Federal Housing Administration Multifamily Housing Program.

The Federal Government has tried a number of different approaches to provide housing over the past 50 years. The FHA Mortgage programs is a public/private partnership that encourages the private sector to produce housing with support from the Federal Government. It is been one of our most successful efforts.

The FHA Multifamily Insurance enables moderate income working families to obtain affordable rental housing. FHA multifamily programs currently insure more than $41 million worth of mortgage loans that support over 14,000 multifamily properties containing 1.8 million housing units.

Unfortunately, this year, for the second consecutive year, the multifamily insurance programs have been shut down because they have used up their annual appropriated credit subsidy or loan loss reserve. This happened approxiamately 3 months ago on April 19, 2001, 5 months before the end of the fiscal year. Experts estimate that if we fail to get the programs up and running again, 55,000 apartments will not be constructed or rehabilitated this fiscal year.

Last December, Congress recognized that the multifamily insurance programs might need additional credit subsidies so we provided a supplemental appropriation of $40 million for this purpose, making the release of funds contingent upon the declaration of an emergency by HUD.

Despite requests from many Members on this Committee to release the $40 million of credit subsidies, the Administration has decided not to declare such an emergency, and the $40 million has not been released. Many of us hope that the fiscal year 2001 supplemental conference report was going to include a provision allowing the $40 million to flow with no conditions attached. This provision appears to have not been included in the conference report.

However, even if this additional credit subsidy were released, this still would only sustain the multifamily program for only a few months, not until the end of the fiscal year on September 30, 2001.

At the same time, the Administration has determined on its own, with almost no input from either Congress or stakeholders, that the solution to this problem is to raise the FHA multifamily insurance premiums. This proposed 50 percent premium increase will become effective on August 1, 2001, which brings us to the reason for the hearing today.

As of today, we have the following results, programs that have been shut down since April 19, 2001. Repeated requests by Members of Congress, including myself, that HUD declare an emergency and allow the $40 million appropriated last December to flow to the FHA multifamily insurance programs, but to no avail.

A 60 percent increase in the premiums and many of the multifamily programs which arguably will increase the cost of this housing causing builders to decide not to build or to raise rents, thus decreasing affordability.

An unsuccessful attempt to fix the problem in the Supplemental Appropriations bill and what appears to be a problematic method of calculating how much credit subsidy the programs need, that still has not been fixed.

In summary, we look forward to the testimony of our witnesses today, and hope that you will help us untangle this cluster of interrelated issues and get the FHA multifamily programs back on their feet.

We will have two panels of witnesses. The first panel will consist of Mr. John Weicher, the Assistant Secretary for Housing and Urban Development and the FHA Commissioner.

On our second panel, we will hear from a number of the stakeholders involved in the FHA multifamily insurance programs and I will introduce the second panel a bit later. We will be asking all witnesses this afternoon to address the probable effect of the recent increase in mortgage insurance premiums, the accuracy of current price subsidy rates, and their views about the proposals to increase FHA multifamily loan money.

Before I recognize Secretary Weicher, I would like to indicate that I will recognize Committee Members as they arrive at appropriate times so they may make opening statements.

But at this time, Mr. Secretary, we appreciate your testimony. As you know, we will make, as part of the record, your written text if you would like to summarize or in any way abbreviate your testimony. We will ask you to try to keep your comments to 5 minutes.

Mr. Secretary.

STATEMENT OF JOHN C. WEICHER ASSISTANT SECRETARY, FHA COMMISSIONER U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. WEICHER. Thank you, Mr. Chairman. I want to thank you for inviting me to testify about the FHA Multifamily Mortgage Insurance Program this afternoon.

With me today is Joseph Malloy, Deputy Director of FHA's Office of Multifamily Development. We are glad to have the opportunity to discuss the Subcommittee's concerns about the program. I am going to discuss each of the three issues in turn that you mentioned in your letter of invitation, starting with the mortgage insurance premium increase.

The National Housing Act authorizes the Secretary to set the premium charge within a range of 25 basis points and 100 basis points on the principal obligation of the mortgage outstanding at any point in time. The MIP for most multifamily mortgage insurance programs has been set by regulation at 50 basis points.

In fiscal year 2001, Congress appropriated $101 million for credit subsidy. The Department effectively obligated all the available credit subsidy by May for reasons that I described in my confirmation hearing before you in May. At the end of fiscal year 2000, the Department ran out of credit subsidy for that year, and promptly used the first $12 million of credit subsidy for fiscal year 2001 to fund the projects that were left over in the pipeline. Also, there was an unexpected increase in applications in the 221(d)(3) program project sponsored by nonprofits and that program carries a higher subsidy rate than most other FHA multifamily programs. Some of these projects should have been treated as if they had for-profit sponsors. In recent years, the number of 221(d)(3) commitments has varied, but they accounted for about 13 percent of the credit subsidy obligated in fiscal year 2000, less than 10 percent in earlier years. This year, 221(d)(3) accounts for 40 percent of our commitments, and that is completely unexpected. If the fiscal year 2000 activity level had continued this year, FHA would have obligated approximately $23 million less in credit subsidy, and we would probably not have this problem.

As the Department exhausted credit subsidy, we advised all field offices to halt the issuances of commitments conditioned on credit subsidy in the April 19 mortgagee letter. To meet the need for multifamily housing, the Secretary then decided to request a supplemental appropriation of $40 million for credit subsidy for the remainder of this fiscal year, and at the same time to implement a premium interest. On July 2, the Department published a notice in the *Federal Register* increasing the mortgage insurance premium to 8⁄10 of 1 percent, 80 basis points. The rule and the notice become effective on August 1. At that time, field offices will be authorized to resume issuing commitments for the 221(d)(4) and other positive credit subsidy programs. All FHA commitments issued on or after that date will be processed at the higher premium. Projects in the headquarters' queue for credit subsidy already, those without outstanding FHA commitments will be allowed to proceed to closing at the lower premium of 50 basis points subject to the availability of credit subsidy in fiscal year 2001. The increase in the premium rate will lower the credit subsidy rates in the future.

The purpose of these proposals is both to resume the production of needed multifamily housing and to put FHA's basic multifamily program on a demand basis, similar to the 203(b) program for single family mortgages. This is the third time in 8 years that FHA has run out of credit subsidy before the end of the fiscal year. The Secretary wants to eliminate the stops and starts that plague our programs and make sure that this situation does not happen again. The premium increase of 30 basis points achieves these purposes. It is also in line with the Administration's proposal in the fiscal year 2002 budget.

Turning to credit subsidy rates. HUD, like all other Federal agencies under the Federal Credit Reform Act of 1990, is required to estimate the probable cost to the Agency of its programs and must request credit subsidy as part of its budget in each fiscal year to cover those costs. In calculating the credit subsidy estimates, we look at historic loan performance of our major programs—prepayments, claims, the income FHA receives from application/inspection fees, and other sources of incomes, mortgage insurance premiums, and recoveries from note and property sales. This analysis becomes the basis for the credit subsidy rate in the Federal budget. The performance has improved greatly in recent years. In 2001, the (d)(4) subsidy rate is a little over 3 cents on the dollar, down from 7 cents last year and 12 cents in 1996.

At my confirmation hearing, I promised to conduct a complete reanalysis of the methodology, and make a new judgment as to the appropriate credit subsidy rate and the appropriate MIP. We are now in the middle of that analysis. Meanwhile, we have provided the industry with a computer model and assumptions, and it is my understanding that they are conducting a parallel analysis. And I notice Mr. Petrie's testimony makes reference to the cooperative effort we have engaged in. Once our work is completed, I will make recommendations to the Secretary and to OMB as to whether the credit subsidy rates and the MIP should be changed. The Secretary, as I mentioned, does have the statutory authority to change the MIP, and that is the basis on which we issued the interim rule on July 2, allowing him to raise or lower the MIP within the range of the statutory authority.

To summarize, very quickly on the loan limits, we are proposing a 25 percent increase in the basic loan limits across the board nationally. This is the first increase since 1992. It matches the increase in construction costs, the national increase in the index, since 1992, which is about 25 percent as well.

The result of this will be to increase and to encourage the construction of much needed multifamily rental housing in the major metropolitan areas across the country. I understand the increase has been included in the Senate Appropriations bill but not in the House bill. We hope the Conference Committee will adopt the Senate position to facilitate the production of multifamily housing.

That concludes my statement, Mr. Chairman. Thank you for the opportunity to appear before you.

Senator REED. Thank you very much, Mr. Secretary.

Let me recognize the Ranking Member of the Subcommittee, Senator Allard.

COMMENTS OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, I know we are anxious to get to the questioning. I would just ask unanimous consent that my opening statement be made a part of the record, behind the Chairman's.

Senator REED. Without objection.

Senator ALLARD. I would just comment that this is an important hearing. There are changes that are happening in multifamily housing and issues this Subcommittee needs to look at seriously.

I think the Administration is trying to take a responsible position as far as budgeting is concerned. I want to commend them for that, and look forward to the questioning and response period.

Senator REED. Thank you very much, Senator. Let me begin, Mr. Secretary.

In your testimony, I heard your statement that Secretary Martinez requested a $40 million supplemental request. That request was granted, I understand, with the caveat that an emergency should be declared, or am I confused?

Mr. WEICHER. I believe that is not accurate, Mr. Chairman. We included a $40 million request as part of the Administration's supplemental proposal. And at the same time, we announced an intention to increase the premium to 80 basis points. We intended to resolve the question about the emergency and operating within the budget limits by including the $40 million in the supplemental fully offset, and we were expecting, up until last Thursday, that we would be reopening the program on that basis on August 1.

Senator REED. In a sense, we have battling supplementals. Last December, there was a supplemental that had emergency language in place, and then subsequent to that, there was a supplemental request by the Administration for $40 million.

Mr. WEICHER. That is right, on a nonemergency normal basis.

Senator REED. Which raises the question to me which was can you give us the rationale why you would not declare an emergency in a program that is so important and that a shortfall that could have been remedied by simply declaring an emergency, at least partially remedied.

Mr. WEICHER. Mr. Chairman, the Administration policy has been and remains to operate within the normal budget process, except in very unusual situations, and we are perfectly prepared to allocate the $40 million in credit subsidy within the supplemental.

It is the Administration's view that emergencies are responses to natural disasters, to problems of that magnitude, not to temporary suspensions in on-going programs. That is what has been at issue here and what remains at issue.

We felt the way to handle this was on the normal order, $40 million appropriated in the normal process, within the spending caps established and the supplemental fully offset, and on that basis, we are certainly prepared to go forward.

But we do not see and Congress does not see this as an emergency or see this as worth funding in the normal way. It makes it harder to argue that it is an emergency. It is our feeling that we have tried very hard to work out a problem which we did not like and which the industry did not like and which Congress did not like certainly. We are sorry that the product has come out this way in the supplemental.

Senator REED. Let me turn to you a moment for the whole issue of the subsidy rates and the controversy that has developed about the accuracy of the calculations. There is a contention that the credit rates are not being calculated accurately and that in fact less money is required to be appropriated for FHA programs to satisfy the requirements of the Credit Act.

If this is the case, then we could find ourselves in a much better position where Congress could appropriate less money, HUD is able to keep premiums lower, and the programs which operate. Indeed, I think it could be a win-win. You have already indicated you are reviewing carefully the methodology. Do you have any at least preliminary conclusions with respect to the level of subsidy that is necessary?

Mr. WEICHER. No, Senator, I do not. We are literally in the middle of the process at this point. I am satisfied that we are proceeding in an appropriate way to do the analysis that we have set up the analytical framework properly.

I have not seen any results at this point that I consider to be properly done within that framework. It is a process of deciding how to do it and then a process of getting the correct data entered into it.

And we are in the middle of doing a statistical analysis within the framework that we have created. It is a high priority, I can assure you, and we intend to be done with the analysis by the end of the fiscal year barring some unexpected problem. But at this point I am not in any position to indicate results.

Senator REED. Let me cease for the moment and just suggest that we do a second round.

Senator ALLARD. That would be fine.

Senator REED. Let me recognize Senator Akaka, who has just joined us and who is the newest Member of the Subcommittee, and ask you if you would have an opening statement that you would like to present at this time?

STATEMENT OF SENATOR DANIEL K. AKAKA

Senator AKAKA. Thank you very much, Mr. Chairman, Senator Allard. I commend you for holding this hearing today that will address the housing issues facing many low and moderate income families involved in the Federal Housing Administration's multifamily insurance programs.

I also wish to thank Mr. John Weicher, the FHA Commissioner and Assistant Secretary for the Department of Housing and Urban Development and other witnesses for coming today to testify before this Subcommittee.

This Subcommittee has a responsibility that was known many years ago. It goes all the way back to 1934. Since then, this Government has been very active in helping average folks get housing and FHA has gone through many changes to carry out its mission.

According to the National Low Income Housing Coalition, approximately 44 percent of Hawaii's renters are unable to afford a 2 bedroom unit. The Coalition has calculated that Hawaii's average rent for a 2 bedroom is $859. Therefore, a worker in Hawaii would need to earn $16.52 per hour working 40 hours per week in order to afford an $859 unit. That is what we are faced with in Hawaii. Mr. Chairman, I ask that my statement be placed in the record.

Once again, I am pleased the Chairman is willing to hold a hearing and look forward to hearing the witnesses today. Thank you.

Senator REED. Thank you.

Senator Allard, questions.

Senator ALLARD. Thank you, Mr. Chairman.

I just want to point out to Members of the Subcommittee and the panel that Denver, Colorado has had the highest increase over the last 10 years in the cost of housing of any place in the country. They have a 43 percent increase. So personally, I am interested in making sure that we have a program that is as self-sufficient as possible and one that will meet our issues of affordable housing. I want to follow up a little bit on the questioning that the Chairman has started out on, $40 million in credit subsidy.

Now, you said in your statement that we have 3 years here where we have a $40 million supplemental, is that right? Did I misunderstand that? What were you talking about over that 3 years?

Mr. WEICHER. Three times in the last 8 years, we have run out of credit subsidy before the end of the fiscal year.

Senator ALLARD. I see, and then you have come in and asked for more, is that what you have done?

Mr. WEICHER. Last year, when HUD ran out at the end of the fiscal year, they simply took the projects that were in the pipeline, funded them out of the 2001 appropriation so that the first $12 million of this year's projects, the first $12 million in credit subsidies for this year's projects were projects that had been proposed and were in the pipeline in the year 2000.

Senator ALLARD. I guess that was my question. There is a $40 million credit subsidy provided through a supplemental appropriation last year, am I correct?

Mr. WEICHER. During the calendar year. During the present fiscal year but at the end of the last calendar year.

Senator ALLARD. Part of the problem for me is that it sounds like it is forward funding, pulling it into the current year to make your shortfalls up. Is that what is happening?

Mr. WEICHER. The full credit subsidy allocation for last year and the full appropriation for last year was used on projects that were in the pipeline and approved in fiscal year 2000. We had an excess demand for credit subsidy at the end of fiscal year 2000, and that excess demand was funded with money that you appropriated for fiscal year 2001. Then at the end of the calendar year, Congress appropriated this emergency supplemental $40 million for fiscal year 2001.

Senator ALLARD. I would like to compliment, as a Member of the Budget Committee, the Administration for trying to straighten that out. I recall, Mr. Chairman, at a previous hearing that we had, that we had $12 billion of unobligated funds in HUD. That was a previous hearing that we had.

The Chairman and I served together on another Subcommittee, probably one of the most expensive Subcommittees, because we are dealing with missile programs and such. We could take your unobligated funds and have a tough time spending them on that particular Subcommittee where we have a lot of defense.

I want to compliment you on trying to establish some sanity in this budget process. The forward funding issue is one of those things that I think is deceptive, and it is quite difficult for some of the Members to understand. I agree with that. I also want to compliment you on not trying to abuse the emergency funding process. Because when you have the emergency funding process, the disadvantage of it from a policy standpoint is that it gets considered part of the funding. The disadvantage to the Administration there is it becomes part of the base. So it kind of shortfalls you on the other side.

So I agree with you that if you make this part of the regular funding process, I think it works much better for those of us who are concerned about the policy issues. And also the Administration is trying to hold some responsible funding and spread the stream of funding for your programs, and that is also important to you.

Is it the Department's view that the FHA Multifamily Housing Mortgage Insurance Program should be self-financing in the same manner as FHA's single-family programs?

Mr. WEICHER. That is certainly what we are trying to do with the 221(d)(4) program, which is our base multifamily program. If we can do that—and we believe that an 80 basis point premium does that—then we will no longer need to have hearings where we try to deal with this kind of problem, and we will no longer need supplementals for credit subsidy or emergency appropriations or anything else along that line any more than we now do with 203(b), which works effectively without the need for anybody to appropriate anything.

Senator ALLARD. We have your single-family program that has the surplus. In fact, that was part of our issue last year is how you are going to spend that surplus. You had too much. I notice here on multiple families, we have just the opposite. We are not able to meet the needs of the program. So I do agree there needs to be some adjustment there if you want to make it self-sufficient. I think from a budget standpoint, it makes a lot more sense. Please discuss FHA's intention to raise insurance premiums, specifically how raising insurance premiums could lower the amount of credit subsidy FHA needs to pay off insurance claims.

Mr. WEICHER. We have to pay an insurance claim from basically two sources. It either has to be through the money we have received in mortgage insurance premiums or it has to be from money that Congress appropriates. And for many years, I think back to 1970, it has been necessary to have appropriations for the multifamily insurance programs. The premium income has not covered the losses on claims.

And so from year to year, there has been this requirement for an appropriation. If we raise the insurance premium, every dollar that we raise the insurance premium reduces by a dollar the amount of credit subsidy that needs to be appropriated. We do not measure it in those terms. We talk about basis points and the one in terms of the insurance premium rather than dollar amounts. We talk about dollar amounts in credit subsidies. But there is a very direct relationship.

And by raising the premium to 80 basis points, we will bring in for every billion dollars worth of mortgages, we would bring in an extra $3 million worth of revenue. Three million dollars per year enables us to avoid the need for credit subsidy and to avoid the need for appropriations. We believe that we can pay the claims we will incur out of the premium income. We will be able to cover our losses, and we will have a program which is operating on a fiscally solvent basis.

Senator ALLARD. Mr. Chairman, I see my time has expired. Are we going to have a second round after this?

Senator REED. Yes. Thank you, Senator.

Senator Akaka, any questions.

Senator AKAKA. Thank you very much, Mr. Chairman.

Mr. Weicher, I believe that the Administration sets the credit subsidy based on the history of defaults and losses in the program. In your review of the credit subsidy methodology, you have found that the current process takes into account changes in tax policy and other economic situations that can affect default rates or changes in HUD's underwriting procedures over the past decade that have lowered default rates. Have you found that the current process does this? And does it take into account tax policy and other economic situations?

Mr. WEICHER. The procedures that have been followed take into account the historical experience of FHA over the life of the program. The procedures that we are working on attempt to identify the separate effects of changes in tax policy, of which we have had several over the years, most recently in 1986.

We take into account specifically also changes in underwriting procedures. And there was a major change in 1991. And we take into account changes in economic circumstances, whether the economy is strong or whether the economy is in recession. And we try to identify the separate effects of each of those so that we can go forward in estimating the experience of the program, estimating the losses that we will incur, and the prepayments will incur, which also affect our premium income, and on that basis to identify how much if any credit subsidy we will need.

It is not an easy process. You are trying to disentangle three different important factors so that we can look forward analytically to what happens under the underwriting standards that we now have and expect to have and under the tax laws that we now have and expect to have and under the economic circumstances that we can expect to have. It is difficult and time consuming, but we think at the end of it we will have more information than we had before.

I might say that this is not the first time that the analytical framework has been reviewed and modified. It happened 4 years ago I believe, and of course it was originally set up in 1992. And then from year to year, there are minor adjustments so that the actual credit subsidy rate is modified based on the additional experience we have even when we are not doing a major reanalysis.

But it seemed to me that the industry representatives that I spoke to on this raised serious concerns that I thought should be investigated freshly. So we started doing that after this Committee confirmed me and I was sworn in by the Secretary.

Senator AKAKA. Thank you so much for that response. I am always concerned how far back concerning the history and calculating this, and I am glad to see there are flexibilities in here. I am concerned that credit subsidy rates may not be accurate and that less money may need to be appropriated for the FHA programs in the GI, SI funds. If this were the case, we could find ourselves in a win-win situation. Congress could appropriate less money. HUD could keep premiums at 50 basis points, and the programs could continue to operate.

You testified that you are reviewing how the Administration sets limits. What is your analysis of whether less credit subsidy is actually needed for these programs?

Mr. WEICHER. We have not yet completed the analysis, Senator. Therefore, we really do not have a judgment at this point as to whether the credit subsidy rate or the premiums should be changed. At this point we are operating under the best evidence we have so far. And the best evidence we have is that the program will be able to cover its costs at the 80 basis point premium that the Administration has requested.

Where our analysis will come out at this point I do not know. We are, as I said in response to the Chairman's earlier question, we are in the middle of the process. I am satisfied that we have a solid analytical framework for the work we are doing. But we do not yet have results.

I have spent a professional career personally doing the kind of work that we are doing here using the same sort of analytical techniques, and I know that when you start on an exercise like this, it takes time and effort, and you always find in the process that you did not do something quite right the first time, and you make a choice and do A instead of B, and then you decide maybe I ought to see if D makes the difference. And it is not an easy process.

But I am sure we are proceeding in an appropriate way. And when we have results, we will be making recommendations to you. And I would be delighted to be able to operate this program on a demand basis at an appropriate mortgage insurance premium.

Senator AKAKA. Do you have an idea of when the time might be when you would be able to do that?

Mr. WEICHER. I believe I said to the Chairman that we expect to complete this analysis by the end of the fiscal year. That is certainly our target.

Senator AKAKA. Thank you, Mr. Chairman. My time is up.

Senator REED. Thank you, Senator Akaka.

Senator Corzine, would like to make an opening statement?

STATEMENT OF SENATOR JON S. CORZINE

Senator CORZINE. Mr. Chairman, I appreciate you holding this hearing. I have a statement that we can put in the record. I also understand that increasing the loan limits, which is something Senator Carper and I have proposed, is generally noncontroversial. There are a number of those on the Subcommittee and in the Administration who support it. I would like to make sure that I hear that in reality. Certainly I believe it will make a difference in the interest of private construction to enter this arena.

On the other issues, though, I have the same kinds of concerns that I am sure other people are voicing. There is a huge need for affordable housing. Broadly speaking, there is almost a 9 year wait for multifamily FHA-sponsored housing. In Newark, we have an incredibly high cost rental housing market, across New Jersey, whether the middle-class or lower-income families. And I think the lack of utilization of this $40 million is hard for me to understand, given its relatively small position in the overall budget process with such an incredible need. I know this is not unique with New Jersey. It is true across the country. My question is more of a statement. Why are we not moving forward on something that seems so obvious and there seems to be general agreement?

Mr. WEICHER. Senator Corzine, the Administration proposed to include $40 million in credit subsidy in the supplemental appropriation which the President sent up, and each House approved it separately and the Conference Committee dropped it. It was our view that the $40 million would be appropriately spent within the normal budgetary process with a full offset within the spending caps. And until last week, we expected that we would be reopening this program with the $40 million in credit subsidy next week.

Senator CORZINE. Is there emergency authority that would allow you to sidestep the fact that it is not in the Conference Report?

Mr. WEICHER. The Administration has taken the view since the beginning that this program would be funded through the normal budget process and not on an emergency basis. The Administration has wanted to operate within the budget framework and not start spending outside the budget process. Funds that we spent should be accounted and be offset through the normal, regular budgetary procedures. We were prepared and still are prepared to implement the program, to reopen the program on that basis.

The Administration is not prepared to declare an emergency. The Administration is quite surprised that Congress is unwilling to approve the $40 million when, as far as we could see, there was no controversy whatsoever about the $40 million as it went through the supplemental appropriations process.

Senator CORZINE. And I suppose if there were an amendment when the VA/HUD appropriation process comes onto the floor that we would be able to count on the Administration's support?

Mr. WEICHER. If you are proposing a $40 million credit subsidy for this fiscal year through the fiscal year 2002 appropriation, I am not sure when that is likely to become law. But typically it becomes law very close to the end of the fiscal year if not after the end of the fiscal year, and then we are into fiscal year 2002. And we will have projects in the pipeline which will then be covered under the fiscal year 2002 rules, presumably under the 80 basis point premium that the Administration has announced.

I am not sure how a $40 million appropriation is part of the fiscal year 2002 appropriation. Forty million dollars supplemental for 2001 would in fact benefit the projects which are now here.

Senator CORZINE. Thank you.

Senator REED. Thank you.

Senator Carper, do you want to make an opening statement? Then do you want to recognize all the witnesses in the next panel?

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. I would like to recognize them all. Kevin Kelly is here from Delaware, President of Leon Weiner & Associates. Kevin has been in the housing business forever, as long as many of us have been alive.

[Laughter.]

Senator CARPER. And people in the audience who laughed know him well. I am one of the people. Kevin Kelly is going to be on the second panel, and I have to start presiding at three o'clock, so I probably will not be here to hear all that he is going to say. But we are delighted that you are here.

A question for Mr. Weicher. I just want to say to Senator Corzine, I appreciate the opportunity to work with him in what appears to be maybe the only noncontroversial thing John and I have done this year with lifting the limits on multifamily housing.

I just want to understand, Mr. Weicher, if I could, I just got in here in January. I understand there was some work done last year to try to provide the $40 million. It got caught up in the supplemental appropriation. Your Administration had the ability to free that money up by declaring an emergency, but chose not to. Then it was put in an appropriations bill, but then dropped out in conference. I know you have probably been trying to explain what is going on here.

Mr. WEICHER. We do not quite know exactly what is going on. We were surprised as anyone to hear at the end of last week that the Conference Committee had dropped the $40 million from the supplemental, which, as far as we could see, was equally as noncontroversial as raising the mortgage limits by 25 percent. We thought we had a solution which provided the resources to continue operating the program for the remainder of the fiscal year that provided them within the normal budgetary process, provided them with the full offset, proper scoring, and we could go ahead with the program. And we had been expecting it until the end of last week.

We had been expecting that on August 1 we would reopen the program. We have projects in the pipeline, projects in the queue and projects with approval, subject to the availability of funds to receive credit subsidy and we expected that we would be back in business. And it appears now that while we have some small amounts of money that have not yet been appropriated because they have not yet been allocated to us when we reopen the program, we will not be able to fund all of the projects that have already been approved.

We really do regret that the appropriations Conference Committee found other uses for the funds. We thought that $40 million would solve the problem that had bothered us since very early in the Administration.

Senator CARPER. Is there any way to fix it at this late date, or is it a done deal?

Mr. WEICHER. I do not know how you would deal with that other than through an amendment to the supplemental appropriation. I doubt if it would provide funds in time to be available during the current fiscal year, as I understand you all will be working on the conference on the HUD/VA appropriation bill during the recess, and that seems to be the normal schedule. But it seems unlikely to me that you would then have the legislation passed and have the President sign it in time to make much of a difference in the present fiscal year.

Senator CARPER. Why not just declare an emergency?

Mr. WEICHER. Because the Administration does not believe that you should be operating outside of the normal budget process. We believe this program should be funded as other programs are funded, as part of the normal budget, normal appropriations process, and we are more than ready to proceed on that basis.

The Administration has indicated from the beginning that it was not willing to declare an emergency simply to avoid the budget rules. That remains the Administration's position.

Senator CARPER. Could I ask one more question? I understand there are a number of projects in the pipeline waiting for additional credit subsidy. In order to move forward, any idea what might be the impact of a change in premiums on those projects?

Mr. WEICHER. I do not think we have tried to calculate that for individual projects or for projects that are now in the pipeline. Some will be approved, because there is the money that was not yet allocated when we suspended the program in April. For those projects, it does not matter.

We do know that we are talking about an increase of about 2 percent in rents from the calculations that we had done earlier when we made our proposal back in May I believe, May or June, so we know that this could make a little bit of a difference in the rent levels on the moderate-income and middle-income projects, assuming a project owner chooses to increase rents.

And in return for that, we will have a program which will be operating on a demand basis like the 203(b) home mortgage program, and we will no longer need credit subsidy, and we will be able to insure any project that meets our underwriting guidelines without worrying about competing with other projects that are in the pipeline and without having to worry about whether we have $40 million or $8 million or $101 million in credit subsidies that we have appropriated at the beginning of the fiscal year, and we think at that point our job and your job will be much easier.

Senator CARPER. Thank you.

Mr. Chairman, thank you.

Senator REED. Thank you.

Mr. Secretary, we have covered the machinations of the budget process, which has resulted in bringing us to this place. But what concerns me more is the policies adopted by HUD.

Essentially what you have decided to do by raising the insurance premiums and not aggressively seeking subsidies is to reduce the subsidies going into the multifamily units, increasing rents to renters, impeding the production of units when these projects become more expensive to developers, at a time when we face a crisis in housing across this country; housing for people who are working just to get affordable rents, that is independent of whether or not you declare an emergency or whether or not it is in the supplemental conference. You have decided now going forward that you are going to raise the price of this to the developers and to renters of this housing at a time when we need to do more to make housing more affordable. Now I think that is the effect. Do you disagree?

Mr. WEICHER. I think we are doing several things here, Senator we are making it possible for the industry to produce multifamily housing on its own production schedule without having to worry about getting it into this fiscal year or next fiscal year, getting it in under the $86 million 221(d)(4) credit subsidy that it appropriated last fall. That is going to make life easier for developers, and that is going to, to some extent, as it makes it easier, will make it less expensive for them to produce housing. We do not have to worry about the budgeting and appropriations procedures that you all go through and we go through in the process of operating this program. I think that is a major step forward, and it is highly desirable to be able to do that.

Senator REED. Do you have any estimates of how much money you are going to save the developers, translated into reduced rents?

Mr. WEICHER. No I do not, Senator. But I am reasonably sure that if you make the job easier for them it will get translated into reduced rents.

Senator REED. There is another view. You can make it less expensive for them by subsidizing what they do. They also like that too.

Mr. WEICHER. Certainly. And if Congress were to continue to provide subsidies on the scale on which it has provided subsidies in the past, we would operate the program on that basis.

Senator REED. It seems to me, Mr. Secretary, you have rejected that approach by saying you do not want to take subsidies. You want to increase the mortgage premiums and create, as you say, a demand basis for this housing program. If you are not asking for the money, it makes it difficult for Congress to give the money.

Mr. WEICHER. We believe, Senator, that the proposal that we have made, the Administration made for an 80 basis point premium and a demand program is the appropriate way to operate this program. The Section 221(d)(4) program is not a program under which rents are subsidized. We are not dealing with low-income renters here. We are dealing with moderate- and middle-income renters, people who are not dependent on Federal assistance to live in decent housing. It is certainly desirable to have a larger stock of affordable multifamily housing. We believe that the approach that we are taking here contributes to that.

Senator ALLARD. Mr. Chairman, would you yield just briefly? It seems to me, Mr. Chairman, that if we have a program that is self-sufficient, that means those dollars are going to be available throughout the year. And that to me means more affordable housing, not less. And when you have this subsidy coming in at the whim of Congress or you have to break budget rules to do that, then I do not think that provides a reliable source of revenue.

If you have a reliable source of revenue coming in through the years to get these projects going, it provides more money for the program so that you have more opportunity for affordable housing. So to me it seems like they are on the right track when you provide some self-sufficiency.

That is what is happening in the single-family when we have a program here, single families, we have premiums that we are providing for that. So that is a consistent program that gets funded throughout the year. That way, it goes to the surplus.

So it seems to me like this, if you really want more affordable housing in the multifamily area, I think this is the right way to go, and I will yield back. And you can have some of my time, Mr. Chairman.

Senator REED. Just one additional question. It goes to the legal basis for the determination of the Secretary by notice, and not by notice and comment rulemaking, of this change. I have had some conversations with the Appropriations Committee staff who indicate that this may not be appropriate.

Let me ask, Mr. Secretary, did the General Counsel at HUD render an opinion as to the legal sufficiency of this notice rather than a rulemaking process?

Mr. WEICHER. Senator, we issued an interim rule implementing the Secretary's statutory authority to vary the premium between 25 basis points and 100 basis points. Certainly that interim rule would not have come out of the Department without the concurrences of the General Counsel. It does not come out without the General Counsel's belief that this is an appropriate and legal procedure for the Department to follow.

Having done that, that rule allows the Secretary by notice to vary the premium within that range of 25 basis points to 100 basis points, and the notice that we have issued, on July 2, is in conformity with the interim rule, and we are proceeding on the basis that we understand—and I am not a lawyer—but we understand to be perfectly consistent under the statute. And we know of no problem there.

Senator REED. Could you provide us whatever documentation the Counsel provided, Mr. Secretary?

Mr. WEICHER. I do not know what documentation it will be, but I will ask the General Counsel or the Secretary for information.

Senator REED. Thank you.

Senator Allard.

Senator ALLARD. Mr. Chairman, I want to kind of just for the record ask you this question. We have had multifamily housing developers argue that increasing premiums will have an adverse impact on them and could decrease the number of affordable units being built. So I was just curious.

I know that you have a study that is going to give you a more firm answer, but when you decide to increase the basis points by 30, what sort of figures were you looking at that determined that you needed to increase the basis points by 30? I know it is just kind of you are waiting for that study to come in and more specifically identify what the amount really needs to be, but you sort of gave a guesstimate. I wonder if you could share with this Subcommittee how you arrive at that guesstimate?

Mr. WEICHER. It is an estimate, Senator Allard, but it is not a guesstimate. There is a model now in place on which the credit subsidy is based. And as I was responding to Senator Akaka earlier, we look at the information that we have from our past experience in the multifamily programs, what our premium income is, what our prepayments are, what our claims are or our losses per claim, and on that basis, we calculate whether the projects that we are insuring are in fact going to cover, the losses on those projects are going to be covered by the insurance premium income that we get or whether we are going to run a deficit or need a subsidy.

The calculation that comes from that analytical framework that we now have in place and was last systematically reviewed in 1996, the analysis that we now have in place indicates that the break-even premium is 80 basis points. It is an estimate. It necessarily is an estimate, and from year to year it is always going to be off in one direction or another to some minor extent, but the best estimate that we have at this point until our work is completed is that the break-even premium is 80 basis points. And it was on that basis that the Secretary went forward with the notice under the rule.

Senator ALLARD. Thank you. In single-family loan limits, they are indexed to changes in the conforming limits for Fannie Mae, would it be possible to index the multifamily loan limits in such a way? Could you share with me some pros and cons on that issue?

Mr. WEICHER. It would be possible, Senator Allard. Our basis is that since we were proposing a 25 percent increase in the multifamily loan limits in order to take account of the effects of inflation over the last 8 years, we would like to get that in place before we start entertaining new changes in the procedure.

The advantage is that we would be able to continue serving essentially the same client population from year to year as we saw a little more inflation, although 25 percent over 8 years is not a large amount of inflation per year.

The disadvantage would be that it is different from single-family in that you really have to decide whether are you looking at construction costs, whether you are trying to look at rent levels for your index, whether you are trying to look at income levels for your index. It is harder in this context than it is in a single-family case where you index to a market price for units of which several million sell every year. If you start to index to construction costs on this basis, there is necessarily a little bit more uncertainty. And I think we would want to do a fairly thorough analysis of the alternatives before we put into place an annual indexing formula.

Senator ALLARD. On the premium rates, the third point that you were suggesting up to the 80, you were suggesting that these would probably take effect at the end of this fiscal year.

Mr. WEICHER. Under the notice that we issued, they would take effect on August 1. However, that was in the expectation that we would have the $40 million supplemental. At this point, it will go into effect for any practical purpose on October 1.

Senator ALLARD. I was wondering if there is going to be a lag time from when you incur the liability and when you collect the premium. I was not sure how that would work out in the next fiscal year. So you are thinking that if this gets applied here on August 1 and you begin to build up that reservoir, so by the time you get into the next fiscal year you have enough in your premium reservoir there that you will not be coming into the 2002 year to pay your premiums. That premium increase will take care of that cost. Is that correct?

Mr. WEICHER. In the remainder of this fiscal year, we expect to receive zero premium income under the 80 basis points, because we will not be insuring any loans at the 80 basis points. The program in that sense will start new with an 80 basis point premium starting with projects that are approved on and insured on October 1.

We will have no credit subsidy in the 221(d)(4) on October 1, and we will simply be operating a demand program that will be bringing in 80 basis point premiums month by month, year by year, and then we will be paying claims just as we do under 203(b).

The timing of it will I think not really be a problem. We will be collecting premium income before we start to see any claims. There are few claims in the first year of one of these programs. And then there will be a very few. But we will bringing in premium income before we incur any claims.

Senator ALLARD. Mr. Chairman, I just want to make a few more comments.

Senator REED. Please go ahead.

Senator ALLARD. Just as a final note as we draw this panel to a close, I just want to make clear that I am very supportive of raising the loan limits. As I noted earlier, Denver has had the highest increase in construction costs in the Nation of 43 percent from 1992 to today. I think it is important that we raise those loan limits.

I think it is also important to note that if this program is made self-sufficient and if it is run like a business, we will be able to support for more development of affordable housing. It is difficult to see how FHA can compete effectively with the starts and stops of the current environment.

So we should do two things here, I believe: Raise the loan limits and make the program self-sufficient as we go forward. The FHA single-family program is self-sufficient. It works very well. And it is a good pattern for us to follow. Thank you, Mr. Chairman.

Senator REED. Thank you, Senator Allard.

Thank you, Mr. Weicher, for your thoughtful, careful testimony. Thank you very much.

Mr. WEICHER. Thank you, Senator.

Senator REED. I would like to call the next panel. If they would come forward, please.

[Pause.]

Let me welcome the panel and introduce our witnesses. First, Mr. Michael Petrie. Mr. Petrie is appearing on behalf of the Mortgage Bankers Association of America. He is President of P/R Mortgage and Investment Corporation, Indianapolis, Indiana, and a current Chairman of the Commercial Real Estate/Multifamily Housing Board of Governors. We want to welcome you, Mr. Petrie.

Next, Mr. Kevin Kelly, who has previously been introduced by my colleague, Senator Carper. Kevin is President of Leon Weiner & Associates, Wilmington, Delaware, a home building, development, and property management firm. Mr. Kelly is testifying today on behalf of the National Association of Home Builders and is currently serving on the NAHB Executive Committee.

Next to Mr. Kelly is Mr. Patton H. Roark, Jr., appearing on behalf of the AFL–CIO Housing Investment Trust. He is currently Executive Vice President and Investments and Portfolio Manager of the Trust. The AFL–CIO Housing Trust has invested over $3 million in units of single and multifamily housing nationwide.

And finally, we are joined by Mr. Carl A.S. Coan. Mr. Coan is a senior partner in the firm of Coan & Lyon, and he is testifying on behalf of the National Housing Conference. He is the National Housing Conference Director and Executive Committee member.

Before you begin, gentlemen, I would like to thank you all for your written statements and indicate they will be made part of the record and ask you if you would observe our 5 minute time limit for oral testimony. I thank you again for joining us. And Mr. Petrie, you may begin.

STATEMENT OF MICHAEL F. PETRIE, PRESIDENT P/R MORTGAGE AND INVESTMENT CORPORATION ON BEHALF OF MORTGAGE BANKERS ASSOCIATION OF AMERICA

Mr. PETRIE. Thank you, Mr. Chairman, Members of the Subcommittee. The reason for our testimony here today is to address the constraints in the FHA multifamily programs and to find solutions to improve and strengthen the FHA programs to provide affordable rental units.

We have always seen the FHA programs as a public/private partnership and look forward to working with the Congress and Mr. Weicher as he takes over the FHA programs to strengthen this partnership.

First I would like to commend Senators Corzine and Carper for introducing Senate bill 1163. This bill would increase the maximum mortgage limits for FHA multifamily programs. These limits have not been increased since 1992, and construction costs alone have risen since then, on average, of 25 percent. The fact that the maximum mortgage limits have not been increased in almost 10 years has virtually shut down the FHA multifamily insurance programs in many high-cost urban markets.

As important as this issue is, however, approving higher loan limits alone will accomplish little without addressing the issue of credit subsidy. Without credit subsidy, or more importantly, without an accurate accounting that demonstrates that credit subsidy is not needed, there will be virtually no new construction with FHA insurance, and the increase in loan limits will be a hollow victory.

As we have stated in our written testimony, the Federal Credit Reform Act changed the budgetary treatment of credit programs to require an analysis before loans are insured of the long-term cost of the programs.

We believe that HUD and OMB since the beginning of credit reform in 1992 have overestimated the cost to the Government of the FHA multifamily insurance programs. This overestimation has distorted the HUD budget by requiring appropriations that were not needed and by underreporting income from profitable programs.

Since the arrival of Secretary Martinez and Mr. Weicher, both HUD and OMB have been very generous in sharing information about the calculation of the credit subsidy rates. It appears from our analysis of the data they have provided that there are 2 key drivers to the credit subsidy rate. The first is the cumulative claims rate which, put simply, is the percentage of loans originated each year that are expected to default and result in a claim. The second is the point at which these claims are expected to occur. For the cumulative claims rate, HUD and OMB are currently using a 28 percent default rate. This is based on the entire experience of the programs since 1956.

The highest claims rates are for loans originated in years affected by major tax changes, the early 1970's and the early 1980's. By removing those years from the calculation or by reducing their weight in the calculation, the credit subsidy rate would drop dramatically. Another way to approach the cumulative claims rate would be to focus more on the recent experience of the programs.

In 1991, FHA implemented significant underwriting changes. Since then, the claims experience has been excellent, actually less than 4 percent. We believe that HUD's assumptions for credit subsidy should eliminate the experience of those unusual periods and should be more heavily weighted to recent experience which reflects how FHA is underwriting loans today.

As I mentioned, the other key factor in the credit subsidy calculation is the point at which these loans will result in a claim which has been heavily front-loaded. This approach has an adverse impact on the credit subsidy rate.

Because of the very favorable claims experience on loans originated since 1992, the reestimated credit subsidy rates have dropped dramatically from the original rates. Congress has appropriated over $1.4 billion since 1992 for credit subsidy. More importantly, none of these funds have been expended. And based on the budget, HUD and OMB do not expect a large portion of these funds ever to be needed.

Based on our experience and review of the data, we believe that these programs make money at the current 50 basis point MIP, and do not require a credit subsidy appropriation. A correctly calculated credit subsidy rate would be negative and therefore MBA thinks the 30 basis point increase in the mortgage insurance premium being implemented by HUD is unnecessary.

We have asked HUD to delay the implementation of the premium increase until a full review of the credit subsidy formula can be completed and an accurate rate determined.

Our concern today, Mr. Chairman, is accuracy, it is also timing. We need accurate credit subsidy rates calculated by September 1. And we need Congress to include those rates in the fiscal year 2002 HUD/VA appropriations bill now being considered in the House of Representatives and the Senate.

We look forward to working with you, Mr. Chairman, and your Subcommittee and other Members of Congress, HUD, and OMB to reexamine the calculation process and the data used to determine the subsidy rate. Thank you for the opportunity to testify today.

Senator REED. Thank you.

Mr. Kelly.

STATEMENT OF KEVIN KELLY
PRESIDENT, LEON N. WEINER & ASSOCIATES
ON BEHALF OF
THE NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. KELLY. Thank you, Chairman Reed, Members of the Housing Subcommittee. As indicated earlier, I am speaking on behalf of the 203,000 member firms of the National Association of Home Builders. NAHB wishes to express its appreciation to the Members of the Subcommittee for holding this hearing on the FHA mortgage insurance programs.

At your request, I will confine my comments to a proposal to increase the FHA mortgage insurance loan limits, HUD's proposed interim rules to increase mortgage insurance premiums, and the need for credit subsidy and appropriation.

Earlier this year, HUD Secretary Mel Martinez announced the Administration's support for increasing the FHA multifamily loan limits. NAHB applauds the Administration for this initiative, and thanks Members of this Subcommittee, particularly Senator Corzine and my own Senator Carper, for introducing S. 1163, legislation to increase the loan limits by 25 percent.

The FHA multifamily loan limits have not been increased since 1992. NAHB's economics department studies show that construction, land, and other costs in 10 metropolitan areas around the country have increased about 25 percent over the past 8 years.

Because of the current dollar limits on these loans, FHA mortgage insurance cannot be used to help finance construction in a number of high cost areas. NAHB, as part of the Affordable Rental Housing Coalition, supports S. 1163 as one means of addressing the shortage of affordable rental housing.

Congressional appropriations of adequate levels of credit subsidy as a necessary part of the functioning of the FHA multifamily insurance programs. This appropriation is required by the Federal Credit Reform Act which applies to all Federal direct loan and guarantee programs.

OMB determines the subsidy rates based in part on an evaluation of the historic performance of these programs in recognition of potential costs to the Federal government.

Higher loan activities in these programs could have budgetary impacts. Due to the exhaustion of credit subsidy, the FHA multifamily programs have been shut down since April. An estimated $250 million in credit subsidy is needed to operate these programs for fiscal year 2001, while only $101 million was appropriated for this period.

The Administration requests that only $15 million in credit subsidy appropriations for fiscal year 2002. This undermines the ability of the programs to provide affordable rental housing.

The question of how much subsidy is actually required is a fundamental issue. NAHB questions the assumptions used by OMB to determine the credit subsidy requirements.

Utilizing the Section 221(d)(4) program, as an example, OMB over-emphasizes performance of loans from the early 1980's which were insured under weaker underwriting standards than today.

Section 221(d)(4) insured mortgages after 1991 have a cumulative default rate of 5.5 percent, while OMB's model employs a cumulative default rate of 28 percent. Other assumptions used by OMB are also excessively pessimistic.

NAHB believes that these programs are performing well, experience cumulative default rates that are significantly below the levels OMB uses. If OMB revised its models and assumptions in the Section 221(d)(4) program would have a negative credit subsidy rate and would not require credit subsidy appropriations or an increase in insurance premiums.

NAHB seeks immediate review and revision of the OMB credit subsidy model and we urge Congress to make the results effective for fiscal year 2002.

The Administration has pursued another route to address the need for an appropriation of credit subsidy. Recently, HUD exercised its statutory authority to set mortgage insurance premiums for multifamily programs by publishing an interim rule increasing the premiums for multifamily programs from 50 to 80 basis points.

NAHB believes that this increase will significantly impair the capacity of multifamily mortgage insurance programs to deliver affordable rental housing.

Analysis by industry experts shows that the premium increase would result in rental increases of 3 to 4 percent, which would undermine the capacity of the program to serve moderate- and lower-income families. In some cases, builders would forego projects.

It should also be noted that these projections reflect the current low level of interest rates. Should interest rates fluctuate upward, the impact on affordability would even be more onerous. NAHB believes that the Administration has acted precipitously by issuing this rule at this time. It has put the cart before the horse. We have seen no studies documenting the need for a 30 basis point increase in the premium structure.

In fact, many acknowledge that perhaps OMB should review its assumptions in calculating the credit subsidy. Furthermore, the rule is scheduled to take effect on August 1, prior to the receipt of any public comment.

We do not believe the premium increase should take effect prior to the study of the credit subsidy or input from the lending and housing industry.

We hope that the Congress will appropriate the sufficient credit subsidy to keep the programs running while working with the Administration to resolves these complex issues. This concludes my remarks, Mr. Chairman.

Senator REED. Thank you, Mr. Kelly.

Mr. Roark.

STATEMENT OF PATTON H. ROARK, JR.
EXECUTIVE VICE PRESIDENT AND PORTFOLIO MANAGER
AFL–CIO HOUSING INVESTMENT TRUST

Mr. ROARK. Good afternoon, Mr. Chairman, Members of the Subcommittee. On behalf of the AFL–CIO Housing Investment Trust, let me first thank you for the opportunity to testify and applaud you for holding today's hearings on major issues related to FHA's multifamily program.

I would like to submit for the record my full written testimony but will recognize that the time allotted to me for my remarks that will highlight my testimony.

There is a national housing crisis, and crisis within the production community. My testimony will focus on HUD's recently proposed 60 percent hike in the FHA 221(d)(4) mortgage insurance program and its impact on the loan program.

I will also comment on the accuracy of the credit subsidy rates and the need to increase the statutory loan limits. The AFL–CIO Housing Investment Trust recommends that Congress take a number of steps to ensure greater multifamily housing production and a stronger FHA.

We recommend that HUD and OMB inform Congress and the public of the real impact of the increase in the cost on housing insurance on housing costs and rent inflation before implementing any increase.

Second, require full and open discussion of the model and the assumptions used in deriving the credit subsidy rates for FHA's mortgage insurance programs.

And finally, increase statutory loan limits by at least 25 percent provided for in the legislation and introduced by Senators Corzine and Carper.

In addition, loan limits to be indexed to ensure program effectiveness on an ongoing basis and additional flexibility should be provided and loan limits for high cost areas.

The number of all rental units in the United States increased by just 2.3 percent during the 1990's. During the same period, the number of households increased by 14.7 percent. The result is a predictable imbalance between housing supply and demand. In major markets across the country, increases in rents have far outstripped inflation and income growth. Rising rents are pricing working families right out of the rental housing market. We are simply not producing enough rental housing.

Through the 221(d)(4) program that provides mortgage insurance for both construction and permanent loans, which allows institutional investors like the AFL–CIO Housing Investment Trust to buy securities backed by these loans. This credit enhancement provides lower cost of capital borne by projects and results in the production of housing units and rent affordability. The impact of the increased mortgage insurance premium will cause negative production and will cause rent inflation.

According to the 2002 budget, HUD forecasts that $3 billion in FHA-insured 221(d)(4) mortgage commitments will be issued in fiscal year 2002. The proposed 30 basis point hike in the mortgage insurance premium would effectively be a tax of approximately $105 million on new multifamily projects. For these development projects to remain viable, the $105 million must be absorbed by tenants through rent increases further escalating the affordability crisis facing working families.

I have received the FHA multifamily budget model. Based on my review and the consultation with senior economists at MBA, I can only say that the model assumptions do not reflect the default experience of the last decade, and that independent review is needed on all assumptions to determine validity.

The model, as mentioned, is very sensitive in three key assumptions; the seasoning curve, cumulative default rates, and recovery rates upon property disposition. Each assumption used in the calculation appears to be biased toward the actual default experience of 1970 through 1989, and not over the last 10 years.

From 1974 to 1990, FHA operated under a coinsured lending and underwriting program. During this time, FHA delegated loan underwriting, third party reporting, and commitment authority to lenders. The program lacked significant internal controls to prevent waste, abuse, and resulted in significant losses to FHA and taxpayers.

In addition to the program's flaws, the Tax Reform Act of 1986 changed the commercial real estate landscape. In 1990, however, the Coinsurance Underwriting Program was officially terminated and was replaced with full insurance.

Since then, to the credit of FHA, significant steps have been taken to restore the integrity of the program. Today, lenders are monitored, very stringent underwriting processes and standards are followed, and only FHA has the authority to commit to mortgage insurance.

Mr. Chairman, this is a key point. The default experience for production after 1990 has declined dramatically. However, the model assumes a default rate of 28 percent. If a fair, independent third party evaluates the current and future default risk of the multifamily portfolio, using the data from the last 10 years, we suspect that the 60 percent increase in the mortgage insurance premium would not be necessary.

What we are asking today is to lift the shroud of secrecy that determines the supposed cost to the Treasury of the program and require FHA and OMB to work with the industry to develop a fiscally responsible subsidy model and mortgage insurance rates.

Mr. Chairman, I would like to submit a letter from President John Sweeny of the AFL–CIO on behalf of the 40 million Americans who live in labor households. President John Sweeney and many State and local labor leaders hear every day about the impact that the housing crisis is having on working men and women and their families across the Nation.

He joins us in urging FHA to resume its historic leadership position supporting the production of multifamily housing. Mr. Chairman, I would be pleased to answer any questions or to brief the Subcommittee at any time.

Senator REED. Thank you, Mr. Roark.

Mr. Coan.

STATEMENT OF CARL A.S. COAN, JR.
EXECUTIVE COMMITTEE MEMBER
NATIONAL HOUSING CONFERENCE

Mr. COAN. Thank you, Mr. Chairman. I am Carl Coan. I appear here on behalf of the National Housing Conference of which I am a director and member of the Executive Committee. We appreciate this opportunity.

NHC was founded in 1931, 3 years before the National Housing Act became law. During all these years, NHC has supported FHA and its various programs to help Americans become better housed. These programs have been essential in helping to achieve the significant progress that has taken place over the past 70 years, yet much still needs to be done.

Our research affiliate, the Center for Housing Policy, last month released a study entitled “Paycheck to Paycheck: Working Families and the Cost of Housing in America.” We have brought multiple copies up here and have them outside, and we have given the Staff copies as well. This study followed up on the Center’s report last year entitled “Housing America’s Working Families.” Both studies found that over 13 million families in 1997 and again in 1999 had critical housing needs. For example, they either spend more than 50 percent of their income on housing, or they live in a seriously substandard unit. Many of these families were on welfare or had only a marginal attachment to the labor force. In 1997, 22 percent, about 3 million households, were working families earning between

$10,700 a year—the equivalent of a full time job at minimum wage—and 120 percent of the area median income, a figure well in excess of $50,000 in some of our more expensive urban areas. In 1999, this percentage increased to 28 percent and the number of households that are fully working households increased to over 3.7 million. These are the families for which the FHA unsubsidized multifamily programs were designed to serve.

Starting with the original 207 program as it was revised in 1938, then through the 608 program enacted during the Second World War, next through the 221(d)(4) program enacted in 1961 and various permutations since then, the FHA multifamily programs have always been aimed principally at providing housing for families of modest income. And because that goal was achieved so successfully in many cases, these programs have frequently been called upon to provide housing for low-income families.

During this over 60 year period, the mortgage insurance premium charged on multifamily mortgages has for the most part been ½ of 1 percent. Incidentally, I started in FHA in 1958, it was half a percent then, and I guess it will be until August 1. This premium has generally been adequate to cover the losses incurred by the mortgage insurance funds established in support of these programs. In the early years of FHA, each program, such as the 207, the 220, or the 221 program had its own mortgage insurance fund. This became cumbersome. Congress in 1965 combined into one fund, the General Insurance Fund, all of the FHA programs except for the basic 203(b) single-family and the cooperative programs.

There also was established in 1968, a Special Risk Insurance Fund in recognition of the fact that some of the programs being carried out under the aegis of FHA were designed to take a greater risk in order to accomplish such goals as housing low-income families or making housing available in older, declining urban areas. While the same mortgage insurance premium was collected with respect to these undertakings, it was recognized up front that the premium would not be sufficient to cover anticipated losses and that Congress would need to appropriate funds on occasion to make up for shortfalls in the Special Risk Fund.

While the Special Risk Fund still exists, for budgetary purposes, it has been lumped in with the General Insurance Fund and there is little, if any, distinction between the two. While erasing that distinction—as was the distinction between the various separate funds erased with the establishment of the General Insurance Fund in 1965—may make it easier for the accountants to keep their books, it should not be used as one of the bases for increasing the mortgage insurance premium. It might be reasonable to consider shifting some of the riskier insurance programs now covered by the General Insurance Fund into a revitalized Special Risk Fund.

The FHA multifamily programs carry out an important societal responsibility of our Government. They have done that successfully over the past 60 some years. The efforts to meet that responsibility should not be lessened now through a 60 percent increase in the mortgage insurance premium. This increase will not stop the FHA multifamily housing programs, but it will certainly limit the programs' ability to serve those with modest income.

The proposed increase in the mortgage insurance premium is like a new tax being added on to the rent of the many thousands of tenants who need the modest cost, decent housing these programs are designed to provide. Incidentally, we, the AFL–CIO Housing Investment Trust and I, did not talk about this until just a few minutes ago. There is no question that this increase will be passed through to the tenants of the housing, or the housing will not be built. In either case, the new tax will decrease the ability of the FHA multifamily programs to serve as broad a range of the population as possible.

I would like to digress from my statement for a moment and cite back to 1983–1984, when it was decided to increase the premium on the 203(b), the single-family program, the Mutual Mortgage Insurance Program. That was done for budgetary reasons, just as I think some of what is occurring now is being done for budgetary reasons. It was a big hit, resulting in reducing the so-called anticipated budget deficit. But it also contributed to a huge increase in the fund, so that now we have the large amount of surplus funds that Senator Allard mentioned and others have mentioned and some Members of Congress have focused on as the basis for using this as a subsidy program. But we made a mistake then because we increased the cost of housing and we also decreased some of the sound aspects of homeownership in order to make up for that difference in increased costs.

Of all the arcana perpetrated by our Government on its people, probably nothing is quite as arcane as the so-called credit subsidy calculations carried out with respect to the FHA multifamily insurance programs. As I understand it, they, HUD and OMB, posit the incurrence of costs far in the future based on the unlikely replication of the circumstances and occurrences of the past. These calculations seem more designed to frustrate the ability to meet our Nation's housing needs rather than designed to facilitate meeting these needs. Whether the calculations made under the premises established by OMB are accurate, neither I nor probably anyone else outside of OMB can really understand. What we can understand, however, is that a result of the credit subsidy concept, we have had several stoppages over the last 8 years in the production of multifamily housing for those whose housing needs cannot be met without the support of the FHA mortgage insurance.

This is inexcusable, and even more inexcusable is the refusal of OMB to allow HUD to use the $40 million made available last year in an emergency supplemental. We have an emergency of not being able to meet the continued need for decent housing, which cannot otherwise be served.

One of the problems which has bedeviled the FHA multifamily housing programs in the last few years has been the inability to increase the multifamily mortgage limits. That the Administration has recognized and has waged a 25 percent increase in those limits NHC strongly supports that. We suggest that Congress move that legislation, and at the same time, it might be appropriate to direct HUD to restore the maximum ½ percent mortgage insurance rate and find ways to avoid the frequent interruption of multifamily production, which has occurred over the last 8 years as a result of the institution of the credit subsidy concept.

Mr. Chairman, thank you very much.

Senator REED. Thank you Mr. Coan. We appreciate it.

Let me begin by asking each of the panel members the same question. Basically from Secretary Weicher's testimony, it seems that the policy, or at least what they suggest might happen by raising the premium at the same time of not claiming more subsidy money in terms of credit, that it will be easier for developers and housing producers to navigate the program and they will not have to worry about the starts and stops, in a sense. He said it will be less expensive, so it will be an incentive. Do you think that is going to be the case, Mr. Petrie?

Mr. PETRIE. I do not. I do think—and I happen to have projects that face the 30 basis point increase, and it increases the cost by at least 4 to 5 percent, and it increases the amount of equity, which then increases the return, which means that we are going to have to charge higher rents. The issue comes down to is a big question from the standpoint of why did they pick 30 basis points.

I can tell you where it comes from. They used a default rate of 28.65 percent for 2002. It had a credit subsidy rate of 2.27 percent. If they raised the MIP 30 basis points, it becomes neutral. They backed into the 30 basis points. If the credit subsidy rate would have been 2.5 percent, their credit subsidy rate, they would have been asking for an increase of 35 basis points. This was not something that was studied. This was something that was backed into on a slide rule, and it was something that we think, based on the knowledge that we have, is not needed.

I want to make one distinction. The MMI fund is a fund. The money is held in there for the purposes of the payment of those participants. The GASRI, any funds that come in that make money go straight to the Treasury. They are not held. The funds that you appropriate are held by OMB, okay? What happens is that if you overappropriate funds, they are still held over there until they decide that they are no longer needed.

So the problem we have had here is that they overappropriated, because they have been too conservative. When we consider the $1.5 billion, if you go back to 1992, there is 1.51 percent. The reestimate based on the 2000 budget shows in the 221(b)(4) program it was a negative 2.29 percent. That means in 1992, that cohort of loans made money. Yet you still appropriated money that is still being held by OMB. Yet we have to come back and ask for more money for a program that makes money. We do not think that is fair. We do not think that is good government.

Senator REED. Thank you, Mr. Petrie.

Mr. Kelly, again, you are a developer. Do you think the increase in the premium is going to make it easier for you to produce housing, or will it be otherwise?

Mr. KELLY. No, sir. First and foremost, as a developer of any kind of successful property, the project has to pencil out. And while certainty the process is a factor, the inability to pencil out a project from the get-go will lead you to walk away from it.

In many of these projects, 3 to 4 percent increase in high-cost areas where rents are, say, $1,000, $40 a month on a unit certainly could be a killer. The alternative is increased equity in the project. That again is something that we all make a decision on how much money we can afford to put in any one project. And again, I think these kinds of increases can certainly kill a project.

Senator REED. Mr. Roark, from your perspective?

Mr. ROARK. I echo what my colleagues on the panel just mentioned. There is significant imbalance between housing supply and demand. If a developer cannot pass the higher costs through as rent increases, they have to take a significant reduction of return on capital, or simply not do the transaction. They will invest capital someplace else around the country or in whatever vehicle they want to put it in, and projects will not be built.

We have a lot of transactions that are in this position right now that we have been following. And when they reprice the transaction with approximately 30 basis point increase, the developer has to come up with $500,000 worth of equity on a $20 million deal just to go to closing. And with interest rates going up and down, and with the credit subsidy issue, unresolved, the uncertainty is really affecting the development community.

Senator REED. Thank you. If I can ask Mr. Coan to make a comment. And also you might allude in your comment to the need for this type of housing. Secretary Weicher pointed out that this is not for low-income people that we subsidize but for the typical working class couples that are the backbone of most neighborhoods.

Mr. COAN. Yes, Mr. Chairman, that is what our study shows. Historically, these programs have been aimed at modest-income people. The original 207 program had that goal. The 221(d)(4) program talks about the low- and moderate-income persons. Actually in candor, you cannot serve low-income persons without some kind of a subsidy, but you can reach moderate-income people. But the more you add on to the cost, the less able you are to do that.

I am not a builder, but I am a lawyer who represents builders and lenders, including one of these at the table here. I know very well that this is a major factor if you are penciling out the tight type of calculations you have to do in order to go forward with this kind of project.

Senator REED. Thank you, Mr. Coan.

Senator Allard.

Senator ALLARD. Thank you, Mr. Chairman.

I think the panel raises a good point about the need to ensure that the default rate is being properly calculated. I ask that they provide us with their calculations and recommendations for our Committee to review.

However, I do have one concern. I heard a reference to the default rate of the 1990's. I just want all of us to remember, you know, the 1990's was a time of unprecedented economic growth in our history where we had that kind of economic growth over that long period. But we also had the 1980's, where we had some economic problems during the 1980's and the housing agency was particularly impacted.

So my question is that maybe we should also include the 1980's, for example. We have two decades there where there is a lot of difference, and there were some changes in rules and regulations that probably are going to be difficult to compare. It seems to me like the proper answer is somewhere between those two decades. I do not know how we reach that figure, but it seems to me that could be something we need to look at. Maybe members of the panel, Mr. Petrie, would like to respond to some of those allegations.

Mr. PETRIE. I think you make a very good point with regard to the recession. The 1990's were a good time, a good economic period. We would like to point out that we went back to 1987 in one of our studies. From 1987 to 1998, the five major programs of FHA had default rates of 4.32; 221(d), 4.74; 223(f), .82; health care, 3.7; and hospitals, .17. They generated $336 million in revenue on $21.892 billion, which is a negative 1.54 percent credit subsidy rate back to 1987.

The key to the early 1980's is that our real estate industry today is based on a cash flow business. Appreciation and tax laws have little effect on us. Any change in tax law will basically probably encourage building more than it would anything else. But right now, it would not detour building, which happened then because of the retroactive nature of it, they quit supporting their projects.

But today, we look at it from the standpoint that it would have little effect. We do not think it would be increasing depreciation, which is going to reduce the budgetary income. So from our standpoint, we are a little more insulated than we were in 1986.

But the main factor is, you only have to make—we have looked at the numbers already—two minor adjustments. If you move right now, when they look at the notes sold, when they take notes and they sell them to the secondary market, OMB is only giving them 90 percent of their historical actuals. If you give HUD 100 percent of its historical actual note sales and decrease the default rate from 28.7 to 23.6, you are in a negative credit subsidy rate for the 221(d)(4) program. Twenty-three point six is not a giveaway or nonconservative default rate when the programs were operating at less than 5 percent today.

That is the frustrating part from our aspect. It does not take much to get us there, and that is all we are saying is we need your help, along with HUD and OMB, to bridge this gap, and we can be there in 2002 and not need the 30 basis point increase which we believe is not needed if they are making this kind of money. It is just more money. The way we look at it, it is not for safety and soundness of the programs. It goes straight to the Treasury.

Senator REED. Essentially what has happened is, this is a way that you recapture money originally allocated for housing and use it for any other program in the Federal Government?

Mr. PETRIE. Yes, sir.

Senator REED. In a way, it represents in tight budget years backing away from housing support and putting it into any number of other programs out of the way of housing, and money that we authorize, assuming it is all going to be spent on housing one way or other, ends up being spent otherwise.

Senator ALLARD. Mr. Chairman, these kind of programs could be an overassessment. You could end up in an unallocated fund.

Senator REED. Thank you, Senator.

Mr. COAN. Senator Allard, I would question the points you raised. I think one has to realize that this is a very inexact science. In the budget appendix that came out for this coming fiscal year 2002, 2001's estimate is a negative subsidy outlay of $216 million. Just last year it was estimated as only $8 million negative outlay.

They are off by over $200 million. And that is true throughout this whole process. That is why I refer to this as the most arcane process going. It is not possible really to understand it. And I have been working at this for about 40 years, and I do not understand it, and these gentlemen, now they have the program that OMB uses and perhaps might ultimately learn how to understand it.

But it is susceptible to manipulation. That is a serious concern that you Members of the Senate ought to have—that these figures can be manipulated to do whatever any Administration wants to do. That is inappropriate, and these changes can only be done by legislative action, not by the manipulation by somebody at OMB.

Senator ALLARD. I think if members of the panel could show us how they derive their figures, I think it would be helpful, and we will ask HUD to come forward and show us how they do their figures and do some comparisons.

Senator REED. I would in response to the point that was just raised, I do think it is appropriate to salute Secretary Martinez and Secretary Weicher for sharing the information for the first time. I think that is something very commendable, and that we should salute them on the record for that effort. I appreciate that very much, and I join with Senator Allard in asking that you would share with us not only your conclusions but also whatever model they gave you, and maybe we could pursue it further.

The final question, and that is, is this information in these models being assessed by anyone outside the housing community? This is not to suggest you are not objective.

[Laughter.]

Senator REED. But is there anyone out there looking at this? Your center, Mr. Coan, is looking at this? An academician who has got expertise?

[No response.]

Senator REED. In that case, that might be something that we could inspire and sponsor.

Thank you all for your testimony. The hearing is adjourned.

[Whereupon, at 3:50 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF JOHN C. WEICHER

ASSISTANT SECRETARY FOR HOUSING, FHA COMMISSIONER
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

JULY 24, 2001

Chairman Reed, Ranking Member Allard, distinguished Members of the Subcommittee, thank you for inviting me to testify on the FHA Multifamily Housing Mortgage Insurance Program.

In your letter of invitation you express interest in three issues: the impending increase in mortgage insurance premiums; program credit subsidy rates; and, the Administration's proposed increase in the per unit mortgage loan limits.

Mortgage Insurance Premium Increase

The National Housing Act authorizes the Secretary to set the premium charge for insurance of mortgages. The range within which the Secretary may set the charges must be between ¼ of 1 percent per annum (25 basis points) and 1 percent per annum (100 basis points) of the principal obligation of the mortgage outstanding at any time. The mortgage insurance premium (MIP) for most multifamily mortgage insurance programs has been set by regulation at ½ of 1 percent of the average outstanding principal balance of the mortgage per year. (A different calculation is used for the construction period to account for the disbursement of mortgage proceeds during construction.)

In fiscal year 2001, Congress appropriated $101 million for credit subsidy. The Department effectively obligated all of the available credit subsidy by May, for reasons that I described in my confirmation hearing at that time. At the end of fiscal year 2000 the Department ran out of credit subsidy, and promptly used the first $12 million of credit subsidy for fiscal year 2001 to fund the projects left over in the pipeline. Also, there was an unexpected increase in applications in the 221(d)(3) program—multifamily housing sponsored by nonprofits—which carries a higher credit subsidy rate than most other FHA mutifamily programs. Some of these projects should have been treated as having for-profit sponsors. In recent years, the number of Section 221(d)(3) commitments has varied, but they did account for about 13 percent of the credit subsidy obligated in fiscal year 2000. This year, it accounts for 40 percent. If the fiscal year 2000 activity level had continued this year, FHA would have obligated approximately $23 million less in credit subsidy, and we would not have this problem.

As the Department exhausted its credit subsidy, we advised all field offices to halt the issuance of FHA commitments conditioned on credit subsidy. To meet the need for multifamily housing, the Secretary then decided to request a supplemental appropriation of $40 million in credit subsidy and at the same time to implement a premium increase. On July 2, the Department published a notice in the *Federal Register* increasing the multifamily mortgage insurance premium for the programs requiring credit subsidy to 8⁄10 of 1 percent or 80 basis points. The rule and notice become effective on August 1 and field offices will be authorized to resume issuing commitments for the positive credit subsidy programs. All FHA commitments issued on or after that date for the specified programs, primarily our Section 221(d)(3) and 221(d)(4) new construction/substantial rehabilitation programs, will be processed at the higher premium. Projects in the headquarters queue for credit subsidy with outstanding FHA commitments will be allowed to proceed to closing at the lower premium subject to the availability of credit subsidy in fiscal year 2001. The increase will lower the credit subsidy rates.

The purpose of these proposals is both to resume the production of needed multifamily housing, and to put FHA's basic multifamily program on a demand basis, like the 203(b) program for single-family mortgage insurance. This is the third time in 8 years that FHA has run out of credit subsidy before the end of the fiscal year. The Secretary wants to eliminate the erractic behavior that has plagued our multifamily programs, and make sure that this situation does not happen again. The premium increase of 30 basis points achieves these purposes. It is on target with the Administration's proposal in the fiscal year 2002 budget.

Credit Subsidy Rates

Under the Federal Credit Reform Act of 1990, HUD, like all other Federal agencies with loan programs, is required to estimate the probable cost to the agency of its programs and must request credit subsidy as part of its budget each fiscal year to cover those costs. In calculating the credit subsidy estimates, HUD has engaged contractors who looked at the historic loan performance of FHA's major programs—prepayments, claims, the income FHA receives from application/inspection fees, mortgage insurance premiums, and recoveries from note and property sales. This analysis becomes the basis of the credit subsidy rate in each year's Federal budget. Loan performance has greatly improved in recent years. In fiscal year 2001 FHA's major new construction program, Section 221(d)(4) required a subsidy of 3.35 cents for each dollar of loan insured. That is down from 7.12 cents last year and 11.96 in 1996.

The industry has questioned the underlying data used in the credit subsidy calculations and the underlying assumptions. At my confirmation hearing I promised to conduct a complete reanalysis of the methodology, and make a new judgment as to the appropriate credit subsidy rate and the appropriate MIP. We are now in the middle of that analysis. Meanwhile, we have provided the industry with the credit subsidy computer model and assumptions, and it is my understanding that they are conducting a parallel analysis. My staff met with industry representatives 3 weeks ago and agreed to further analyze some issues that were particularly important, in their view. The industry also believes that the 1986 changes in tax law, and more recent changes in FHA underwriting standards, are not given adequate weight in the credit subsidy analysis. In our work, we are evaluating their concerns and how they might be accounted for. Once the staff analysis is complete, I will make recommendations to the Secretary and to the Office of Management and Budget as to whether the credit subsidy rates and the MIP should be changed. As I mentioned, the Secretary now has statutory authority to change the MIP; under that authority, the Department issued an interim rule on July 2, which allows the Secretary to raise or lower the MIP within the range of his statutory authority.

FHA Statutory Per Unit Limits

The National Housing Act includes per unit limits by bedroom size for the various new construction/substantial rehabilitation programs with a maximum adjustment of 140 percent (with exceptions for Alaska, Guam, and Hawaii) where the Secretary determines it is necessary on a project-by-project basis. The base limits in the National Housing Act have not been raised since 1992. The effect has been to limit the use of the FHA multifamily mortgage insurance programs in high cost areas of the country like Boston, New York, Philadelphia, Chicago, and San Francisco because the FHA maximum insurable mortgage would be controlled by the mortgage limits rather than economic considerations such as debt service or replacement cost. This would result in much greater equity requirements for developers in those areas, and a disincentive to use the programs.

In analyzing construction cost data for 74 selected cities across the country, we found that construction costs had increased an average of 25 percent since 1992. For that reason the Secretary and the President have proposed an increase of 25 percent in the base limits. Individual projects will still be able to take advantage of the maximum 140 percent adjustment where feasible and appropriate. We believe this will encourage the construction of much needed multifamily rental housing in the major metropolitan areas across the country.

This concludes my statement, Mr. Chairman. Thank you again for the opportunity to appear before you.

PREPARED STATEMENT OF MICHAEL F. PETRIE

PRESIDENT, P/R MORTGAGE AND INVESTMENT CORPORATION, INDIANAPOLIS, INDIANA
ON BEHALF OF MORTGAGE BANKERS ASSOCIATION OF AMERICA

JULY 24, 2001

Mr. Chairman, and Members of the Subcommittee, my name is Michael Petrie, and I am President of P/R Mortgage and Investment Corporation in Indianapolis, Indiana. I am appearing before you today in my capacity as Chairman of the Commercial Real Estate/Multifamily Housing Board of Governors of the Mortgage Bankers Association of America (MBA).[1] MBA is grateful for the opportunity to present

[1] MBA is the national association representing the real estate finance industry. Headquartered in Washington, DC, the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,800 companies includes all elements of real estate finance; mortgage companies, mortgage brokers, commercial banks, thrifts,

Continued

our views to your Subcommittee today on the important issue of the FHA multifamily credit subsidy.

I have spent over 20 years in the commercial real estate finance industry. Before joining P/R Mortgage and Investment Corporation, I worked at Merchants National Corporation, where I rose to the rank of Executive Vice President and head of the Commercial Real Estate Division. My present firm, P/R Mortgage & Investment Corporation was started in 1990, has financed over $700 million in multifamily mortgages and the firm currently services $550 million in loans. Since inception, the firm has never had a 30 day delinquency on any loan.

I am also an active volunteer in affordable housing; I served 8 years on the Board of the Indianapolis Neighborhood Housing Partnership and am currently on the Mayor's Indianapolis Housing Strategy Task Force. I was previously a Chairman of Near North Development Corporation Board of Directors and served on the Board of United Northwest Area CDC. I have served 16 years as President of Kenwood Place, Inc., an inner city 97 unit Section 202 housing development for the elderly, and 4 years as President of Unity Park, Inc., an inner city 60 unit Section 8 family development.

What Are the FHA Multifamily Programs and How Do They Work?

The Federal Housing Administration (FHA) was created under the National Housing Act of 1934. It was developed initially to attract private and public sector credit into the housing market to meet mortgage financing needs of low-, moderate-, and middle-income Americans by insuring long-term, fully amortizing single-family and multifamily mortgages. From its beginning, a major responsibility of FHA has been to enhance the Nation's multifamily housing stock. FHA facilitates the construction and maintenance of multifamily housing by providing mortgage insurance to finance the construction, purchase, rehabilitation, or the refinancing of rental housing, cooperatives, and condominiums. Over the years, FHA has been expanded to include programs for the finance of special needs groups such as the elderly and disabled. Each of the programs is referred to by the section of the National Housing Act, as amended, under which it is authorized.

FHA's multifamily mortgage insurance programs enable qualified borrowers to obtain long-term, fixed rate, nonrecourse, financing for a variety of multifamily property types affordable to low- and moderate-income families. Out of the cash flow of a property approved for FHA-insured financing, the borrower pays a mortgage insurance premium (MIP) to the lender which is then passed through to FHA in return for the insurance. The MIP charged is intended to compensate FHA for its risk and the cost of doing business, including the expected cost of default.

However, despite an acute need for affordable rental housing throughout the Nation, over the past 4 years, the FHA has insured fewer than 130,000 units in the entire country. The reason for our testimony here today is to address the program constraints in the FHA multifamily programs and to find solutions to improve and strengthen the FHA programs to provide affordable rental units.

Why Is It Important To Raise the FHA Multifamily Loan Limits?

First, I would like to commend Senator Corzine and Senator Carper for introducing S. 1163. This bill would increase the maximum mortgage limits for the FHA multifamily programs. These limits have not been increased since 1992 and construction costs alone have risen since then, on average, by 25 percent. S. 1163 is particularly helpful in that it not only increases the limits by 25 percent, but it also provides for an annual adjustment factor to the limits so that we do not face this same problem again in a few years.

The fact that the maximum mortgage limits have not been increased in almost 10 years has virtually shut down the FHA multifamily insurance programs in many high-cost markets. In most major cities in this country, and many second-tier cities, it is impossible to produce new housing using the FHA programs. In cities like Boston, where almost 120 percent of all working families have critical housing needs and there is only a 2.7 percent vacancy rate, it is vitally important to produce new housing. Yet, because of the maximum mortgage limits, no new FHA new construction or substantial rehabilitation loans were approved in Boston in 2000. Even in second-tier cities like my hometown of Indianapolis, the maximum mortgage limits have made it difficult to do FHA-insured loans.

S. 1163 is key to making FHA insurance a useful tool in high-cost areas, and we fully support the bill. We suggest that the Senators consider adding a provision to their bill to allow the Secretary the discretion, on a project-by-project basis, to in-

life insurance companies and others in the mortgage lending field. For additional information visit MBA's Web site: *www.mbaa.org.*

crease the loan limit's high-cost factor to the one currently allowed for Alaska and Hawaii. This would provide the Secretary the ability to address needs in particularly high-cost areas like Boston, New York, or San Francisco where land and development expenses are particularly high.

As important as this issue is, approving higher loan limits alone will accomplish little without addressing the fundamental issue now facing the FHA program—the lack of credit subsidy. Without credit subsidy or without an accurate accounting that demonstrates when credit subsidy is needed, there will be no new construction with FHA insurance, and the increase in the loan limits would be a hollow victory.

What Is Credit Subsidy?

While many people believe calculating the credit subsidy rates for FHA's mortgage insurance programs is merely an accounting detail, it is clear this accounting detail has shut down the FHA new production programs for months at a time for 2 years in a row and resulted in the loss of new affordable housing. We believe it is time these "details" are brought to light and publicly debated so an accurate accounting of these programs can be achieved.

The Federal Credit Reform Act changed the budgetary treatment of credit programs, effective for fiscal year 1992. The Act requires Congress to appropriate funds for the "estimated long-term cost to the Government of a direct loan or loan guarantee." It states that "the cost of a loan guarantee shall be the net present value when a guaranteed loan is disbursed of the cash flow from (i) estimated payments by the Government to cover defaults and delinquencies, interest subsidies, and other payments, and (ii) the estimated payments to the Government including origination and other fees, penalties, and recoveries."

Since 1992, the Department of Housing and Urban Development (HUD) and the Office of Management and Budget (OMB) have determined that most of the FHA insurance programs that support the new construction of multifamily housing require an annual appropriation of credit subsidy. This credit subsidy is supposed to serve as a loan loss reserve for the programs.

We believe that HUD and OMB, since the beginning of credit reform, have overestimated the long-term cost to the Government of the FHA multifamily insurance programs. This overestimation has resulted in unnecessary money being appropriated for these programs and, therefore, "wasted."

Since the arrival of Secretary Martinez and Dr. Weicher at HUD, both HUD and OMB have been very generous in sharing information about the calculation of the credit subsidy rates for the FHA multifamily programs. Greater access to the formula, as well as detailed explanations of the assumptions used, has been provided to MBA. We appreciate their openness and their willingness to share their data. It is invaluable in our ability to evaluate the performance of these programs and how we proceed in the future to continue to provide greater access to affordable rental housing in the most efficient method possible.

What Is the Current Credit Subsidy Crisis and How Did It Get To This Point?

It appears from our analysis of the data provided to us that there are two key drivers of the calculation. The first is the cumulative claims rate which, put simply, is the percentage of loans originated each year that are expected to default and result in a claim on the insurance fund during the life of those loans. The second is when in the life of those loans the claims are expected to occur.

For the cumulative claims rate, HUD and OMB are currently using 28 percent. This is based on the entire experience of the Section 220 and 221(d)(4) programs, beginning in 1956. As you can imagine, those rates vary widely—from zero percent for loans originated in 1995 and 1999 to 64.8 percent for loans originated in 1983. The highest claims rates are, not surprisingly, for loans originated in years affected by major tax changes: the early 1970's and the early 1980's. By removing those years from the calculation or by reducing their weight in the calculation, the credit subsidy rate would drop dramatically. Another way to approach the cumulative claims rate would be to focus more on the most recent experience of the programs. Since HUD made significant underwriting changes in 1991, their default and claims experience has improved dramatically. From the data HUD has provided to MBA, the cumulative claims rate has been less than 4 percent for every year from 1992 through 2000.

In my experience as a lender at a bank, when we created loan loss reserves, we looked at the experience of loans similar to loans we were currently underwriting. No one expects that we will ever experience again the devastation in real estate markets that was the result of the tax changes that began with the accelerated depreciation in 1981 and ended with the Tax Reform Act of 1986 which eliminated, retroactively, various tax incentives. If we did expect such a downturn in the real estate market, no one would be investing in real estate today. HUD's assumptions for credit subsidy should eliminate the experiences of that unusual period and should more heavily weight the recent experience, which reflects how financial institutions are underwriting loans today.

As I mentioned, the other key driver in the credit subsidy calculation is the point at which any of these loans will result in a claim. HUD and OMB have heavily front end-loaded the claims. Their calculations assume that 9.3 percent of the loans will result in a claim in the first 3 years of the mortgage and 14.3 percent will result in a claim in the first 5 years of the loan. This approach has an immense impact on the credit subsidy rate.

The impact of HUD's assumptions are evident from the numbers called "reestimates" that appear in the HUD budget. Until recently, the Federal budget included "reestimates" of the credit subsidy needed for each origination year since 1992, the year credit reform was implemented. The reestimates reflect the history of the loans originated in those years and clearly demonstrate that the original calculations were excessively high. For example, loans originated in 1992 had an original credit subsidy rate of 1.51 percent and a reestimated rate in the fiscal year 2000 budget of –2.29 percent. For 1993 loans, the rate dropped from 12.41 percent to 3.70 percent. Similar reductions were evident in subsequent years until HUD and OMB stopped reestimating the rates for loans originated in 1997 and beyond. We believe that HUD and OMB need to review their assumptions, and base their default predictions on more recent experience with loans underwritten since 1991.

What Has Happened With the Annual Appropriation for Credit Subsidy?

By our estimates, Congress has appropriated over $1.4 billion since 1992 for credit subsidy for the FHA multifamily programs. None of these funds have been expended. In fact, based on the reestimates in the budget, HUD and OMB do not expect a large portion of these funds ever to be needed for these programs. Perhaps there is a way to recapture and reuse some of this excess credit subsidy. At the very least, we need to recognize that credit subsidy should not be continually appropriated and never used.

Why Does MBA Oppose the Increase In the Mortgage Insurance Premium?

Based on what we have seen and what we believe to be the correct credit subsidy rates for these programs, MBA thinks it is unnecessary and inappropriate for HUD to increase the mortgage insurance premiums (MIP) on many of these programs. The increase from 50 basis points to 80 basis points to be implemented by HUD is an unnecessary increase that was calculated by using the current, and we believe, flawed formula and assumptions, and HUD merely selected the MIP level that would make the programs breakeven, and, therefore, require less credit subsidy.

This premium increase will have a number of adverse affects on the production of housing. First, for those properties in markets where a rent increase is possible, rents to tenants will also increase by approximately 3.5 to 4 percent. Second, for properties where the market will not support a rent increase, the owner will be required to put substantially more equity into the property. If the owner does not have access to additional equity capital, the property simply will not be built. None of these outcomes is beneficial to the families that need affordable housing, nor to the communities that could benefit from the production of new housing.

Why Increase the Mortgage Insurance Premium Now?

We have asked HUD to delay the implementation of the premium increase until a full review of the credit subsidy formula can be completed and an accurate rate determined. They have responded by publishing the regulation and notice implementing the change effective August 1. We believe this was done to ensure that the $40 million they hoped to have appropriated for fiscal year 2001 would be sufficient to fund all loans in the pipeline this year. Based on Congress' actions last week and their failure to appropriate any credit subsidy, we are asking HUD again to reconsider the MIP increase and hope that you and your Subcommittee will add your voice to ours in asking for a delay in implementation of any premium increase.

Our concern today, Mr. Chairman, is accuracy, but it is also timing. The Congress cannot afford to keep appropriating millions of dollars that are not needed and never used. The developers and mortgage bankers who depend upon these programs for financing cannot operate in this unpredictable and volatile environment. The families who need affordable rental housing cannot wait for it to be built.

We need more accurate credit subsidy rates calculated as soon as possible. And we need Congress to include those rates in the fiscal year 2002 HUD/VA Appropriations bill now being considered in the House of Representatives and the Senate.

Without this quick response, we will be faced with another year of unnecessary appropriations and/or an unjustified and excessive increase in the MIP.

How Has the Action Last Week On the Supplemental Appropriations Bill Exacerbated the Crisis?

While I understand that it is not the primary focus of this hearing, I would be remiss if I did not mention the action by the Congress last week during consideration of the Defense Supplemental Appropriations Act. Through the hard work of you and many of your colleagues on the Banking Committee, both the Senate and House versions of the supplemental included $40 million in credit subsidy for the FHA multifamily insurance programs. This appropriation was needed to end the shutdown of the programs, which began in April when FHA fully committed the $101 million initially appropriated for the programs for this fiscal year.

In unexplained action, the conferees on the bill eliminated the $40 million from the bill, possibly to fund other priorities, even though both chambers of Congress had approved it. Clearly, the conferees did not understand the impact of their actions. Without a supplemental appropriation, the FHA new construction and substantial rehabilitation programs will be shut down until October 1. This will mean that approximately $1 billion of new construction of affordable rental housing will not get underway this year and may never be built. Forty million dollars is not much money, particularly in a $7 billion supplemental appropriation. However, since it was deleted, we will have delayed indefinitely, and perhaps lost, construction on $1 billion of housing. Housing, as you know, is an excellent economic stimulation tool. These projects could have generated more than 24,000 new jobs, more than $126 million in new local taxes and fees, and more than $255 million in new Federal taxes. Unfortunately, an opportunity appears to be gone. And, certainly the rental housing is desperately needed.

There are only two ways that these programs can be restarted before the new fiscal year begins. The Administration can release the $40 million already appropriated by Congress last December as an emergency supplemental for these programs or Congress can approve a new $40 million supplemental, perhaps in the fiscal year 2002 HUD/VA Appropriations bill, if it continues to move quickly through the Congress. We urge you, Senator Reed, to recommend to the Appropriations Committee to consider adding these supplemental funds to the fiscal year 2002 bill. These monies have already been appropriated and they should be used to restart the program. The Senate in the Defense Supplemental Appropriations bill removed all restrictions on that original appropriation. If that same language could be included in the fiscal year 2002 HUD/VA Appropriations bill or another appropriations vehicle that is moving quickly through Congress, we can end this shutdown and begin construction already started this year on much-needed housing.

We look forward to working with you, Mr. Chairman, your Subcommittee, and other Members of Congress to reexamine the calculation process and the data used to determine the subsidy rate. Our industry stands ready to “break the logjam” so thousands of affordable rental units may be produced across the country. Thank you for the opportunity to testify here today.

PREPARED STATEMENT OF KEVIN KELLY

PRESIDENT, LEON N. WEINER & ASSOCIATES, WILMINGTON, DELAWARE
ON BEHALF OF THE NATIONAL ASSOCIATION OF HOME BUILDERS

JULY 24, 2001

Introduction

On behalf of the 203,000 members firms of the National Association of Home Builders, I want to thank you for calling this hearing on the Federal Housing Administration’s multifamily mortgage insurance programs. My name is Kevin Kelly and I am a builder from Wilmington, Delaware. I currently serve as President of Leon N. Weiner & Associates, Inc., a Wilmington based home building development and property management firm. The Weiner organization and its affiliates have developed and constructed more than 4,500 homes, 9,000 apartments as well as several hotels, office, and retail facilities.

Overview

The Federal Housing Administration’s (FHA) multifamily mortgage insurance programs support new construction and substantial rehabilitation of apartments and are a cornerstone of efforts to meet the critical need for affordable rental housing.

These programs, which require Federal budget appropriations in the form of credit subsidy, have been shut down because funding for fiscal year 2001 has been exhausted since April. Furthermore, the Administration's budget request for fiscal year 2002 is also inadequate.

To address the credit subsidy shortage, the United States Department of Housing and Urban Development (HUD) plans to increase the mortgage insurance premium for these programs, which will relieve the need for credit subsidy but will undercut the ability of the programs to provide affordable rental housing. NAHB opposes the premium increase as unnecessary and burdensome. The current credit subsidy requirements are based on flawed calculations, which, if corrected, would allow the FHA multifamily mortgage insurance programs to operate without credit subsidy appropriations or premium increases.

Before the suspension of credit subsidy, these programs were not functioning effectively in a number of key markets due to outdated limits on the size of mortgage that can be insured by FHA. Legislation to increase the loan limits has been introduced in both the United States House of Representatives and Senate and NAHB supports such efforts.

Affordable Rental Housing Shortage

Two recent studies have documented a worsening shortage of affordable housing, particularly affordable rental housing. According to the latest "The State of the Nation's Housing" report from Harvard University's Joint Center for Housing Studies, 14 million Americans had severe housing cost burdens at the close of the decade. The report says that a family that earns the equivalent of a full-time job at minimum wage cannot afford the fair market rent for a two-bedroom apartment anywhere in the country. In 24 States, according to the report, even households with two earners cannot afford the fair market rent for an apartment without paying more than 30 percent of their income. The report also discusses the imbalance between the supply of affordable units and the growing demand for them. It also points out that the limited production of units affordable to low- and moderate-income households is troubling and likely to cause the critical housing needs problem to spread further to moderate-income families.

The National Housing Conference's Center for Housing Policy also recently released a new report, "Paycheck to Paycheck: Working Families and the Cost of Housing in America," with similar findings regarding the increasing housing cost pressure on low- and moderate-income families. The report reveals signs of persistent and worsening housing affordability for working families in all parts of the country, including cities, suburbs and rural areas, despite the recent economic prosperity. Workers in municipal jobs, such as teachers and police officers, and in the services sectors, such as janitors, licensed practical nurses, and salespeople, fall into this group of people and are a large and growing component of many local economies. The growth in such jobs, however, is not matched by the growth in the supply of affordable housing, creating an increasingly difficult situation. According to the report, in 1999 there were 13 million American families that had a critical housing need, which is defined as paying more than 50 percent of their income for housing or living in severely inadequate housing. The proportion of low- to moderate-income working families with critical housing needs has risen from 23 percent in 1997 to 28.5 percent in 1999, going from 3 million to 3.7 million. For renters, the report finds that a janitor or retail salesperson could afford a one-bedroom unit in most of the 60 areas, but in not one of these areas could they afford a two-bedroom unit without paying considerably more than 30 percent of their income for rent. The report also points out that for many people in service-related occupations, including teachers and police officers, two earners in the household are required to pay for housing costs.

The worsening housing affordability situation for low- and moderate-income working families is exacerbated by inadequate mortgage loan limits and shutdowns in the FHA multifamily mortgage insurance programs, which are the chief vehicles for meeting the housing needs of these families.

Credit Subsidy for FHA Multifamily Mortgage Insurance Programs

Each year, HUD must request an appropriation from Congress in an amount estimated to be the probable cost to the Agency of all multifamily mortgages it insures (the credit subsidy). Such appropriations are required by the Federal Credit Reform Act, which applies to all Federal direct loan and guarantee programs. The purpose is to recognize the potential cost of these programs in the Federal budget. For each program, the required credit subsidy is the dollar amount of losses that are expected over the life of the loans that are made or guaranteed in the budget year. The Office of Management and Budget (OMB) establishes subsidy rates for each Federal loan and guarantee program, based on an evaluation of the historical performance of those programs. The subsidy rates determine the amount of money that must be appropriated for any given level of program activity. (Programs that produce income rather than losses are assigned, what is called, a negative subsidy rate. Higher activity levels in these programs, which include the FHA single-family mortgage insurance program, increase Federal budget revenues.)

Each of the different FHA multifamily mortgage insurance programs has been assigned an individual credit subsidy rate. It is estimated that HUD will require more than $250 million in credit subsidy to operate these programs in fiscal year 2001. Only $101 million was appropriated, and that amount was exhausted before the end of April 2001. Such a shortfall means the loss of production of 50,000 units of affordable rental housing. In addition, the President's fiscal year 2002 budget proposal for HUD seeks almost no credit subsidy funding for multifamily mortgage insurance. The budget instead proposes to increase the mortgage insurance premiums for these programs, which would nearly eliminate the need for credit subsidy but undercut the ability of the programs to provide affordable rental housing.

NAHB believes that the assumptions used by OMB to determine the credit subsidy requirement for FHA multifamily mortgage insurance programs are incorrect. For example, the OMB model for the Section 221(d)(4) program places too much weight on the performance of loans from the early 1980's, which were insured under much weaker underwriting standards than employed today and were impacted by the unprecedented retroactive provisions of the 1986 Tax Act. Section 221(d)(4) mortgages insured after 1991 have a cumulative default rate of 5.5 percent, while OMB's model employs a cumulative default rate of 28 percent. OMB's assumptions on recovery from asset disposition, particularly note sales, are also excessively pessimistic. In addition, the model incorrectly assumes that all loans with loan management set-aside assistance (LMSA) result in immediate claims. Finally, the model combines unrelated, poorer performing programs in the credit subsidy rate calculations for the Section 221(d)(4) program.

The multifamily mortgage insurance programs are performing well, experiencing cumulative default rates that are significantly below the level that OMB used in calculating the credit subsidy rates. If OMB revised its model and assumptions to address the problems outlined above, the Section 221(d)(4) program would have a negative credit subsidy rate and would not require credit subsidy appropriations or an increase in insurance premium. NAHB is seeking an immediate review and revision of the OMB credit subsidy model and urges Congress to make the results effective for the fiscal year 2002 budget.

FHA Multifamily Mortgage Insurance Premiums

HUD currently has the statutory authority to set the mortgage insurance premium for multifamily programs from ¼ to 1 percent of outstanding principal balance per annum. HUD's current regulation sets specific percentages within the authorized range; that is, most of the mortgage insurance programs are set at ½ of 1 percent.

HUD and the Administration have announced support for a $40 million supplemental appropriation for FHA multifamily credit subsidy for fiscal year 2001 and are moving forward with an interim rule to increase the multifamily mortgage insurance premium from 50 to 80 basis points. HUD published the interim rule on July 2, 2001. HUD believes that the combination of supplemental credit subsidy and premium increase will allow a restart of the FHA multifamily mortgage insurance programs and support their operation through the end of this fiscal year. The premium increase, which HUD has said will remain in effect at least through the end of fiscal year 2002, will mean that only a minimal level of credit subsidy will be required in the next fiscal year.

The interim rule revises current regulations to permit the Secretary to set the mortgage insurance premiums by program within the full range of HUD's statutory authority through notices. On August 1, 2001, the date the interim rule becomes effective, HUD will raise the MIP from 0.5 percent to 0.8 percent. Programs for which the raise applies include the Section 221(d)(4) program, which is the main program supporting new construction of affordable rental properties, the programs under Sections 207, 220, 221(d)(3), 231, 234(d), and 241(a), as well as the HOPE 6 projects under Sections 207, 220, 221(d)(4), and 231. A notice setting the new premium rates accompanies the interim rule.

HUD is raising the premium without undertaking analysis of its need or impact. The premium change will go into effect without opportunity for public comment. Comments on the rule will not be considered until after the comment period closes on August 31, 2001. NAHB believes this to be inappropriate for a change of this magnitude. As stated above, NAHB believes the premium increase will unnecessarily hamper efforts to meet affordable rental housing needs. The increase will significantly impair the capacity of the FHA multifamily mortgage insurance programs to address the Nation's critical need for affordable rental housing. Analysis by industry experts shows that the premium increase would result in rent increases of 3 to 4 percent, which would undermine the capacity of this program to serve moderate- and lower-income families. In some cases, builders would decide not to go forward with projects, resulting in the loss of affordable rental units. It should be noted that these projections reflect the current low level of interest rates. Should interest rates fluctuate upward, the impact on affordability would be even more onerous.

FHA Multifamily Mortgage Limits

Another factor contributing to the shortage of affordable rental housing, especially in high-cost areas, is the fact that the FHA multifamily mortgage limits have not been increased since 1992. Construction, land, and other costs have increased dramatically during that period. The Annual Construction Cost Index, published by the Census Bureau, increased over 23 percent. Preliminary results from a recent survey conducted by NAHB's Economics Department show that land costs in 10 metropolitan areas have increased by an average of 25 percent over the past 8 years.

These rising construction and other costs have resulted in a shortage of affordable rental units. Rent increases now exceed inflation in all regions of the country, and new affordable units are increasingly rare. Because of current dollar limits on loans, FHA insurance cannot be used to help finance construction in a number of high-cost urban areas. Statistics published by FHA show that in high-cost areas, such as New York and Philadelphia, only a few multifamily loans providing new or substantially rehabilitated affordable rental units have been insured in the last 6 years.

NAHB has proposed that the current statutory mortgage limits be increased 25 percent, which is consistent with reported increases in construction and land costs. The limits should also be indexed based on increases in the Annual Construction Cost Index. Increasing the dollar limits for multifamily loans that can be insured by FHA will foster the development of affordable housing, especially in high-cost center city areas where it is needed most. The NAHB proposal includes increases in limits on loans for: (1) rental housing in urban areas where local governments have undertaken concentrated revitalization efforts; (2) cooperative housing projects; (3) rental housing for the elderly; (4) new construction or substantial rehabilitation of apartments by both for-profit and nonprofit sponsors; (5) condominium developments; and, (6) refinancing of rental properties. Eligible borrowers under these FHA programs may include private for-profit developers, public agencies, and nonprofit organizations.

NAHB strongly supports the legislation that has been introduced to raise the FHA multifamily mortgage limits—Senate version, S. 1163, introduced by Senators Jon Corzine (D–NJ) and Thomas R. Carper (D–DE), and H.R. 1629, introduced in the House by Representatives Marge Roukema (R–NJ) and Barney Frank (D–MA). Also, it is significant that the Secretary of HUD, Mel Martinez, has expressed the Administration's support for such a proposal.

In conclusion, the FHA multifamily insurance programs are critical to the delivery of much needed affordable housing to working families. Considering the pressing need for housing, we respectfully request Members of the Senate Banking and Appropriations Committees to take steps to ensure that unnecessary disruptions to the program are minimized and the programs work as effectively and efficiently as possible. Further, we seek your support of S. 1163 and enlist your help in securing its passage. NAHB stands ready to assist in these efforts and thanks you in advance for your assistance.

PREPARED STATEMENT OF PATTON H. ROARK, JR.

EXECUTIVE VICE PRESIDENT AND PORTFOLIO MANAGER
AFL–CIO HOUSING INVESTMENT TRUST, WASHINGTON, DC

JULY 24, 2001

Good afternoon, Mr. Chairman and Members of the Subcommittee. My name is Patton Roark and I serve as the Executive Vice President and Portfolio Manager for the AFL–CIO Housing Investment Trust.

On behalf of the Trust, let me first thank you for the opportunity to testify today on FHA's multifamily housing program. We applaud you for holding today's hearing on major issues facing FHA's multifamily program, which arise in the context of a national crisis of multifamily housing production. My testimony will focus on HUD's recently proposed 60 percent increase in the FHA 221(d)(4) mortgage insurance premium—from 50 to 80 basis points—and the implications of this increase for the future of this critically important multifamily loan program. We believe that the proposed increase will further depress the production of much needed rental housing and negatively affect the quality of life of working families in housing markets across the United States.

I will also comment on the credit subsidy rates for FHA multifamily mortgage insurance premiums. We question the underlying assumptions and data used to arrive at credit subsidy rates. We have utilized a version of the credit subsidy model obtained by the Mortgage Bankers Association from HUD and applied assumptions and data derived from actual transactions in the FHA 2001 pipeline. Based on this analysis, at an increased mortgage insurance premium of 80 basis points, FHA would appear to earn excess revenues at the expense of multifamily projects and, ultimately, of tenants. A significantly lower premium increase—or perhaps no increase at all in the current 50 basis point premium—may be, necessary to achieve revenue neutrality for the 221(d)(4) program, even assuming a goal of revenue neutrality. What we are asking today is to lift the shroud of secrecy that determines the supposed "cost" to the Treasury of the program and require that OMB and HUD work with the industry to develop a fiscally responsible subsidy model and mortgage insurance rate.

In addition, I will comment on the need to address stagnant statutory loan limits and the stop-and-go character of the program due to insufficient credit subsidy that are further compromising FHA's effectiveness.

The AFL–CIO Housing Investment Trust recommends that Congress take a number of steps to ensure greater multifamily housing production and a stronger FHA:

- Require that HUD and OMB inform Congress and the public regarding the real impact of the proposed increase in the mortgage insurance premium on housing production and rent inflation—before implementing any increase.
- Require a full and open public discussion of the model and assumptions used in deriving the credit subsidy rate for FHA's multifamily insurance programs.
- Increase statutory loan limits by at least the 25 percent proposed by Secretary Martinez and provided for in legislation introduced by Senator Corzine. Loan limits should be indexed to assure program effectiveness on an ongoing basis and additional flexibility should be provided in loan limits for high cost areas.
- Grandfather projects currently in FHA's 2001 pipeline at the current 50 basis point premium level.
- Request that OMB immediately release $40 million in already appropriated emergency credit subsidy funds for fiscal year 2001.
- Appropriate sufficient credit subsidy for fiscal year 2002 to allow the 221(d)(4) program to operate on a full-year basis at the 50 basis point premium level pending the full and open resolution of the mortgage insurance and credit subsidy issues, as we have recommended.

Background On the AFL–CIO Housing Investment Trust

The AFL–CIO Housing Investment Trust is a $2.5 billion fixed-income fund registered with the Securities and Exchange Commission under the Investment Company Act of 1940. The Trust specializes in investing in Agency-Insured Mortgage-Backed Securities for over 400 investors, including both union and public employee pension plans. The Trust is one of the industry's largest investors in FHA-Insured Mortgages and currently invests up to $400 million annually through the Section 221(d)(4) Multifamily Construction Mortgage program.

Thirty five years ago, the AFL–CIO founded the Trust's predecessor, the AFL–CIO Mortgage Investment Trust, with the dual goals of providing a vehicle for the prudent investment of union pension assets and of using those assets to stimulate housing production that would benefit workers and their communities. Over the last 35 years, the Trust and its predecessor have financed over 65,000 units of rental housing through investments in FHA-insured mortgages, securities backed by FHA-insured mortgages, and other mortgage-backed securities. My comments are derived from the Trust's unique perspective on real estate development, capital market trading and asset management.

The Multifamily Housing Production Crisis

The issues being reviewed by the Subcommittee today arise in the context of a national crisis in rental housing production. The United States is barely producing enough new rental housing to compensate for losses from the inventory due to age, condominium conversion, and other causes. The number of all rental units in the United States increased by just 2.3 percent during the 1990's. Over the same period, population increased by 13.2 percent and the number of households increased by 14.7 percent. The result is a predictable imbalance of housing supply and demand. In major markets across the country, increases in rents have far outstripped inflation and growth in incomes. That is why, according to the Joint Center for Housing Studies at Harvard, after a decade of unprecedented economic growth in the United States, 14 million American households—that is one in eight—now pay over half their income for housing or live in substandard apartments. Rising rents are pricing working families out of the rental housing market. We are simply not producing enough rental housing.

The Need for An Effective FHA

Historically, FHA has played a critical role in assuring the production of an adequate supply of new multifamily housing, whether in responding to the crisis of the Great Depression or the need for housing following World War II. During the 1970's and the 1980's, FHA was a major force in the market for financing of rental housing and the country achieved high levels of rental housing production. In 1980, FHA insured 42 percent of the dollar volume of all multifamily loans. During the 1980's, the country achieved a multifamily production level of over 4.5 million units.

During the decade of the 1990's, FHA stepped back from its leadership role in multifamily housing production. By 1997, FHA's multifamily loan market share had dropped to just over 10 percent. During the 1990's, only 2.5 million new rental housing units were produced, just over half of production levels during the 1980's, contributing directly to the crisis in rental housing supply and escalating rents.

FHA plays a unique role in the multifamily housing industry. Its stated mission includes maintaining rental housing opportunities, contributing to the building of healthy neighborhoods and communities, and stabilizing credit markets in times of economic disruption.

Through the 221(d)(4) program, FHA provides insurance for multifamily loans, which allows institutional investors, like the AFL–CIO Housing Investment Trust, to buy securities backed by these loans. The resulting capital market efficiencies lower the cost of capital for projects resulting in lower rents and more projects that are economically feasible.

FHA's insurance program offers some significant advantages that are unique in the industry:

- Mortgage insurance covering both construction and permanent loans. Alternative sources of mortgage loan insurance or guarantees do not cover loans during the construction period. As a result, such alternative sources tend to be used more to refinance existing, stabilized projects than to the create new housing units. Allowing institutional investment in construction loans drives down construction loan interest rates, reduced project costs, lower rent requirements in underwriting, and increasing affordability.
- Fixed, rather than floating, construction and permanent loan rates. This provides predictability to developers, who are otherwise exposed to significant interest rate risk during the development period. Risk reduction translates into lower returns required by equity investors, reducing project costs, and lowering required rents.
- A 40 year loan amortization period, which reduces loan payments and rent levels needed to meet debt service. Alternative sources of credit enhancement in the market have amortization periods of 30 years or less.
- A 90 percent maximum loan-to-value ratio for insured loans. This results in an equity requirement of only 10 percent of total project costs. Alternative sources of multifamily financing require equity levels of 20 percent to 35 percent. Generally, capital markets expect equity rates of return to be at least double mortgage interest rates because of the increased risk of holding equity rather than debt. Why is this relevant to affordability? When the portion of project costs covered by equity is increased, it increases the overall cost of funds. When the cost of funds is increased, it increases the rents necessary to make the project feasible, given prudent underwriting. When required rents are increased, either tenants must pay the difference, or the project is not built. Either way, the result is that fewer American families can afford a place to live.

In summary, each of these components of the FHA multifamily program increases the willingness of developers to build and investors to invest in harder to serve areas. Each component reduces the cost of financing for multifamily projects, thus enabling the development of apartments with affordable rents for working families.

Obstacles To FHA's Effectiveness

Despite the importance of the unique financing tools that the FHA offers, FHA's multifamily loan production has declined over the past decade due to a number of factors:

- The time required to process FHA transactions has been substantially longer than that required for private transactions. For developers, time is money. To address this, HUD introduced the Multifamily Accelerated Processing (MAP) Program, effective this year. Early reports on this program are encouraging.
- Statutory loan limits are too low. These limits have not been adjusted since 1992. This has made the 221(d)(4) program unworkable in high cost markets, precisely where the need is greatest. For this reason, last year there were no FHA loans issued in markets such as New York, Boston, Providence, San Francisco, San Jose, Syracuse, Cincinnati, Birmingham, and many more. Secretary Martinez has proposed to address this problem and legislation has been introduced by Senator Corzine that would increase statutory loan limits by 25 percent. We strongly support an increase by at least 25 percent. We also support indexing the increase in statutory loan limits to assure continued program effectiveness and recommend that additional flexibility be provided for high cost areas.
- The stop-and-go character of the program, due to disputes over credit subsidy, frustrates developers who have played by the rules and relied on the availability of FHA loans. In fiscal year 2000, the 221(d)(4) program was effectively shut down in June. In this fiscal year 2001, the program was shut down in April. The Trust is currently working with developers of projects totaling approximately $100 million, representing over 600 badly needed rental units, who are preparing to walk away from existing FHA loan commitments that cannot be acted on. Their future interest in FHA's programs will depend on assurances that the programs can be relied upon.

The Impact of An Increased Mortgage Insurance Premium

Now HUD is proposing a 60 percent increase in the cost of FHA mortgage insurance. This increase will add costs to the development of multifamily housing and directly contribute to decreased housing affordability in the markets FHA serves.

According to the 2002 Budget, HUD forecasts that $3 billion in FHA-insured 221(d)(4) mortgage commitments will be issued in fiscal year 2002. The proposed 30 basis point increase in the mortgage insurance premium would effectively be a tax of approximately $105 million—present value of the increase over 40 years—on new multifamily projects. For these development projects to remain viable, this $105 million must be absorbed by tenants through rent increases—further escalating the affordability crisis facing working families.

The premium increase could also result in a long-term process of adverse selection that reduces the integrity of the FHA's existing portfolio. Developers who choose to finance through FHA and who have strong, financially viable projects in the most stable markets, may subsequently choose to prepay and refinance out of the FHA program at the first opportunity, leaving only the weaker projects in the FHA portfolio. This tendency to prepay high-premium FHA loans may also be reflected in the capital markets' pricing of the securities—requiring a higher yield because of the increase in prepayment risk.

An increase in the mortgage insurance premium is not justified by high default rates in the insured portfolio. The AFL–CIO Housing Investment Trust has invested over $1.25 billion in FHA-insured multifamily loans over the past 10 years. The Trust, one of the industry's largest investors in such loans, has experienced cumulative defaults of slightly over 1 percent of that total. HUD's statistics back up our experience. Since 1990, the default rate for all loans under the full 221(d)(4) program has averaged about 1 percent annually. For loans originated after 1990, the annual default rate is even lower—just over half that. Why then is HUD proposing to increase mortgage insurance premiums now?

It is important also to be cognizant of current economic conditions. Federal Reserve Chairman Alan Greenspan testified to Congress last week that the economy remains depressed, notwithstanding an unprecedented seven reductions in the Federal funds rate and the prospect of fiscal stimulus through the tax reduction package enacted by Congress and the President. FHA has long been seen as providing a stimulus to the economy by promoting housing construction and thereby creating jobs in construction and related industries. The multiplier effect associated with these jobs is felt throughout the economy. If increasing the mortgage insurance premium by 60 percent risks reducing the production of rental housing at a time when it is sorely needed, a question that this Subcommittee must wrestle with is whether now is the time to risk elimination of these construction and related jobs.

The Need For Independent Critical Evaluation of the Proposed Premium Increase and Credit Subsidy Model

In proposing a substantial increase in the mortgage insurance premium through an interim rule that changes the premium during a fiscal year, HUD is acting precipitously. Department staff do not appear to have adequately consulted with developers, bankers, investors, tenants, housing advocates, or others knowledgeable in the industry or impacted by the decision. HUD is acting without independently verified information regarding the potential near-term and long-term impact of this change on rental housing production or on rent levels.

Moreover, HUD is proposing a fundamental rule change in the middle of the game. This has created serious uncertainty and a lack of confidence in capital markets and among developers. It will layer new costs on pending projects not only because of higher premiums but also due to the need for reunderwriting and new financial feasibility studies.

To restore investor and borrower confidence in the FHA program as well as address the need to increase rental housing production, HUD should immediately contract for an independent critical evaluation of the proposed premium increase and its likely impact on rental housing production and rent inflation. The methodology as well as the results of the study should be made available to Congress and the public within 90 days. A decision to increase the mortgage insurance premium should not be made without a disciplined and open process that examines the likely impacts of such a decision.

Congress should request that the Office of Management and Budget make public the model and the assumptions and data used to determine credit subsidy levels for the FHA multifamily insurance program. We applied data and assumptions derived from current projects in FHA's 2001 pipeline to the FHA Multifamily Budgetary Cash Flow Model obtained by the Mortgage Bankers Association from HUD. Our results are substantially different from those apparently arrived at by FHA and OMB. Our preliminary analysis strongly suggests that a premium of 80 basis points may not be required to offset the actual default risks insured by the program. Our understanding is that certain defaulted projects from the 1970's and 1980's—underwritten under programs and using standards no longer in use today—are skewing the default ratio derived in the model. Such projects do not reflect current risks.

If FHA and OMB fairly evaluate the current default risk of the multifamily portfolio using data from the past 10 years, they will likely conclude that a 60 percent increase in insurance premiums is not necessary to create a revenue neutral program, even assuming a goal of revenue neutrality. Without an open examination of the model and the assumptions and data that went into it, these conclusions remain preliminary. What we can say definitively is that public policy matters as important as the future of FHA and the availability of housing at affordable rents should not be determined behind a shroud of secrecy.

Allow Projects Now Stuck In FHA's Pipeline To Go Forward and Assure Future Program Continuity

We recommend that Congress request that OMB immediately release the $40 million in emergency credit subsidy which has already been appropriated for fiscal year 2001 to allow projects now stuck in FHA's production pipeline to go forward.

Moreover, FHA should allow projects, for which it has invited firm commitments, to be provided financing at the current 50 basis point premium. Developers have relied on the availability of FHA financing at substantial expense. FHA has completed preliminary underwriting and expressed a desire to provide financing. It is a waste of both project and taxpayer resources to mandate that such projects be restructured by developers and then reunderwritten by FHA. By allowing these projects to be financed, the credibility of the FHA insurance program will be enhanced as a reliable financing option and thousands of badly needed rental units will be able to start construction immediately.

To avoid program disruptions next year, sufficient credit subsidy must be appropriated for fiscal year 2002 to assure that the 221(d)(4) program can remain operational through the entire fiscal year at the 50 basis point premium level, pending a full and open resolution of the issues of credit subsidy and appropriate insurance premium level, as we are recommending.

Conclusion

Multifamily housing production in the United States is lagging far behind population growth and household formation—the usual indicators of housing demand. The result is a crisis of housing affordability that is hurting working families in major housing markets across the country. The crisis is predictable, but not inevitable.

To reverse the decline in national rental housing production, FHA must be allowed to do more, not less. FHA programs have played a critical role in rental housing production in the past and with a renewed commitment and appropriate changes, these programs can help lead the country out of its current housing production crisis. Unfortunately, the current HUD proposal to increase mortgage insurance premiums is a step in the wrong direction. It will increase the cost of rental housing production and reduce developer and investor confidence in FHA programs, hastening the erosion of FHA's role in multifamily lending. This is not a desirable outcome and certainly not one that we should back into without full and open discussion and debate.

Mr. Chairman, we appreciate the opportunity to testify before this Subcommittee. I would also like at this point to submit a letter from President John Sweeney of the AFL–CIO, on behalf of the 40 million Americans who live in labor households. President Sweeney and many State and local labor leaders hear every day about the impact that the housing crisis is having on working men and women and their families, across the Nation. He joins us in urging that FHA resume its historic leadership position in supporting the production of multifamily housing.

Mr. Chairman, I would be pleased to answer any questions and to brief the Subcommittee staff at any time.

Thank you.

PREPARED STATEMENT OF CARL A.S. COAN, JR

EXECUTIVE COMMITTEE MEMBER, NATIONAL HOUSING CONFERENCE

JULY 24, 2001

Mr. Chairman and Members of the Subcommittee, I am Carl A.S. Coan, Jr. and I appear here on behalf of the National Housing Conference for which I am a Director and a member of the Executive Committee. We appreciate this opportunity to present our views on the FHA Multifamily Housing Mortgage Insurance Program.

NHC was founded in 1931, 3 years before the National Housing Act became law. During all these years, NHC has supported FHA and its various programs to help Americans become better housed. These programs have been essential in helping to achieve the significant progress that has taken place over the past 70 years. Yet much still needs to be done.

NHC's research affiliate, the Center for Housing Policy, last month released a study, entitled "Paycheck to Paycheck: Working Families and the Cost of Housing in America." This study followed up on the Center's report of last year, entitled "Housing America's Working Families." Both studies found that over 13 million families in 1997, and again in 1999, had critical housing needs, for example, they either spent more than 50 percent of their incomes on housing or they lived in a seriously substandard unit. While many of these families were elderly or on welfare or had only a marginal attachment to the labor force, in 1997 22 percent, about three million households, were working families earning between $10,700 a year—the equivalent of a full-time job at the minimum wage—and 120 percent of the area median income, a figure well in excess of $50,000 in some of our more expensive urban areas. In 1999, this percentage increased to 28 percent, and the number of households to over 3.7 million. These are the families the FHA multifamily unsubsidized programs were designed to serve.

Starting with the original 207 program as it was revised in 1938, then through the 608 program enacted during the Second World War, next through the 221(d)(4) program enacted in 1961 and various permutations since then, the FHA multifamily programs have always been aimed principally at providing housing for families of modest income. And because that goal was achieved so successfully in many cases, these programs have frequently been called upon, with the addition of a subsidy element, to provide housing for low-income families—those earning 80 percent or less of the median income in most cases. The basic structure of the unsubsidized multifamily program was the foundation upon which the subsidy assistance was added, serving as the vehicle for the provision of hundreds of thousands of housing units for low-income families.

During this 60 year period, the mortgage insurance premium charged on multifamily mortgages has for the most part been ½ of 1 percent. This premium has generally been adequate to cover the losses incurred by the mortgage insurance funds established in support of these programs. In the early years of FHA, each program, such as 207, 220, or 221, had its own mortgage insurance fund. This became cumbersome and Congress in 1965 combined into one fund, the General Insurance Fund, all of the FHA programs except for the basic 203(b) single-family and the cooperative programs.

There also was established in 1968 a Special Risk Insurance Fund, in recognition of the fact that some of the programs being carried out under the aegis of FHA were designed to take a greater risk in order to accomplish such goals as housing low-income families or making housing available in older, declining urban areas. While the same mortgage insurance premium was collected with respect to these undertakings, it was recognized up front that the premium would not be sufficient to cover anticipated losses and that Congress would need to appropriate funds on occasion to make up for shortfalls in the Special Risk Fund.

While the Special Risk Fund still exists, for budgetary purposes it has been lumped with the General Insurance Fund and there is little, if any, distinction between the two. While erasing that distinction—as was the distinction between the various separate funds erased with the establishment of the General Insurance Fund in 1965—may make it easier for the accountants to keep their books, it should not be used as one of the bases for increasing the mortgage insurance premium as the Administration announced it intends to do as of August 1. And it might be reasonable to consider shifting some of the riskier insurance programs now covered by the General Insurance Fund into a revitalized Special Risk Fund.

The FHA multifamily programs carry out an important societal responsibility of our Government, and they have done that successfully over the past 60 years. The efforts to meet that responsibility should not be lessened now through a 60 percent increase in the mortgage insurance premium. This increase will not stop the FHA multifamily housing programs, but it will certainly limit the programs ability to serve those of modest income that the programs were designed to serve.

The proposed increase in the mortgage insurance premium is like a new tax being added on to the rent of the many thousands of tenants who need the modest-cost, decent housing these programs are designed to provide. There is no question that this increase will be passed through to the tenants or the housing will not be built. In either case, this new tax will decrease the ability of the FHA multifamily programs to serve as broad a range of the population as possible.

Of all the arcana perpetrated by our Government on its people, probably nothing is quite as arcane as the so-called credit subsidy calculations carried out with respect to the FHA multifamily insurance programs. As I understand it, they posit the incurrence of costs far in the future, based on the unlikely replication of the circumstances and occurrences of the past. They seem more designed to frustrate the ability to meet our Nation's housing needs, rather than to facilitate meeting those needs. Whether the calculations made under the premises established by OMB are accurate, neither I nor probably anyone else outside of OMB can really understand. What we can understand, however, is that as a result of the credit subsidy concept, we have had several stoppages over the last 8 years in the production of multifamily housing for those whose housing needs cannot be met without the support of the FHA mortgage insurance.

This is inexcusable, and even more inexcusable is the refusal of OMB to allow HUD to use the $40 million made available last year in an emergency supplemental. OMB has taken the position that no emergency exists and therefore it could not meet the requirements spelled out in the legislation for releasing that $40 million; we believe that an emergency did and does exist because of the continued need for decent housing in markets which cannot otherwise be adequately served.

One of the problems that has bedeviled the FHA multifamily insurance programs in recent years has been the failure to increase the maximum per unit mortgage limits since the last increase in 1992. This, at least, the Administration has recognized and has urged that Congress enact a 25 percent increase in those limits. NHC strongly supports that increase and urges this Subcommittee to move as soon as possible the legislation providing for that increase. We suggest, however, that at the same time it might be appropriate to direct HUD to restore the maximum ½ percent mortgage insurance premium and to find ways to avoid the frequent interruption to FHA multifamily production that have occurred over the last 8 years as a result of the institution of the credit subsidy concept.

Mr. Chairman, I would like to thank you for this opportunity to present our views and concerns and would be pleased to answer any questions that you may have.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR ALLARD FROM MICHAEL F. PETRIE

Q.1. What would be an appropriate index for setting future increases in loan limits?

A.1. Generally, the loan limits have been most limiting on the new construction and substantial rehabilitation programs. While the cost of land, impact fees, and other development costs have increased significantly, these costs vary widely across markets and a national index would be difficult to determine. However, the cost of construction is generally the largest factor in increasing costs and is more uniform across markets. The Census Bureau publishes, annually, a Construction Cost Index. We recommend that the amount of increase each year in this index be used to adjust the maximum mortgage limits.

Q.2. Please provide us with the data and your analysis that indicates HUD and OMB have overestimated the long-term cost to the Government of the FHA multifamily insurance program, and that a premium of 80 basis points may not be required to offset the actual default risks insured by the program.

A.2. In 1999, MBA commissioned a study by Abt Associates that reviewed FHA data for the four most active multifamily programs. Abt performed a cash flow analysis for each of the programs and used actual HUD data for January 1987 through September 30, 1998. (These dates were chosen because they are after the 1986 Tax Reform Act but include the 1987–1991 real estate recession.)

The attached tables demonstrate that both the Section 221(d)(3) and 221(d)(4) programs make money for the Government with total claims rates of 8.16 percent and 4.76 percent, respectively. The experience since fiscal year 1998 has been even more positive which would increase the positive cash flows of these programs.

There are generally two types of risk that HUD must consider when setting an estimated default rate. The first is underwriting risk or the risk that loans will be poorly underwritten and not be able to achieve the rents necessary for the project to be economically feasible. HUD made significant underwriting changes in 1991 that have proven to be successful in that few loans have resulted in claims in the early years of the mortgage.

Using HUD's own data, the average default rate for the first 3 years of the Section 221(d)(4) loans originated from 1992 through 1998 was 1.65 percent and the average rate for the first 5 years for loans originated since 1992 was also 1.65 percent. (See attached chart.) This compares to the rates assumed by HUD and OMB in their credit subsidy calculation of 9.3 percent for 3 years and 14.3 percent for 5 years.

The second type of risk is economic risk or the risk that the economy in the region or the neighborhood will deteriorate such that the owner can no longer achieve the rents necessary to maintain the property and make the mortgage payments. This risk has not been adequately tested since 1992 because of the sustained economic expansion the country has experienced since 1991. The issue then becomes, what level of defaults should be estimated to take into account an economic recession? HUD is using approximately 28.5 percent for the Section 221(d)(4) program, which results in the need for an 80 basis point MIP. If you were to lower that rate to 21 percent—more than 12 times the actual average rates since 1992—there would be no need for credit subsidy or an increase in the MIP above 50 basis points.

Even the Administration realizes that their credit subsidy rate estimates have been significantly higher than actual experience. Until recently, the Federal budget included "reestimates" of the credit subsidy needed for each year since 1992. The reestimates reflect the actual experience of the loans originated in those years and clearly demonstrate that the original calculations were excessively high. For example, Section 221(d)(4) loans originated in 1992 had an original credit subsidy rate of 1.51 percent and a reestimated rate in the fiscal year 2000 budget of –2.29 percent. For 1993 loans, the rate dropped from 12.41 percent to 3.7 percent. Similar reductions were evident in subsequent years until HUD and OMB stopped reestimating the rates for loans originated in 1997 and beyond. Clearly, the Congress has over-appropriated for credit subsidy for this program—even at a 50 basis point mortgage insurance premium.

Multifamily Development Mortgages

Cumulative Claim Rates (Actual)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	Average
3-year	1.92	3.82	.54	0	1.95	2.26	1.07			1.65
5-year	1.92	3.82	.54	0	1.95	-	-			1.65
Life of loans	2.68	3.82	.54	0	1.95	2.26	1.07	0	0	1.37

Cumulative Claim Rates (Assumed in FHA Credit Subsidy Formula)

3-year	9.3
5-year	14.3

Exhibit 3
Insurance Fund Cash Flow of Multifamily FHA Projects using Current Practice Assumptions
Initial Endorsements between 1987 and 1998
(Amounts in $1,000s)

	Unassisted Multifamily Section 221(d)(4)[a]	Unassisted Multifamily Section 221(d)(3)[a]	Refinances Section 223(f)	Nursing Homes Section 232	Hospitals Section 242	Total
Initial Endorsements						
Amount	$7,190,685	$196,546	$7,773,817	$5,044,390	$1,686,797	$21,892,235
Number of properties	862	49	1,703	788	27	3,429
Fees and premiums paid[b]	$179,599	$6,825	$209,721	$156,023	$57,092	$609,260
Claims						
Total claim amount	$310,801	$9,317	$63,608	$186,465	$2,871	$573,062
Number of claims	41	4	19	42	1	107
Claims rate (Number of claims as percent of number of endorsements)	4.76%	8.16%	1.12%	5.35%	3.70%	3.12%
Claims amount rate (Total claim amount as a percent of total endorsement amount)	4.32%	4.74%	0.82%	3.70%	0.17%	2.62%
Loss recovery rate[c]	54.76%	60.58%	51.43%	48.52%	35.56%	52.36%
Loss recovery	$170,195	$5,644	$32,714	$90,473	$1,021	$300,046
Net claims *(claims - loss recovery)*	$140,606	$3,673	$30,894	$95,992	$1,850	$273,016
Net cash flow *(fees & premiums - net claims)*	$38,993	$3,152	$178,827	$60,031	$55,242	$336,244
As a percent of initial endorsements	0.54%	1.60%	2.30%	1.19%	3.28%	1.54%

See Exhibit 4 for assumptions.

a Section 221(d)(4) estimates exclude coinsured properties and retirement service centers.
Section 221(d)(4) and 221(d)(3) estimates exclude properties that received Section 8 assistance.

b The current practice assumptions do not take administrative costs into account.

c Based on rates provided by the FHA's Comptroller's Office.

RESPONSE TO WRITTEN QUESTION OF SENATOR ALLARD FROM KEVIN KELLY

Q.1 What would be an appropriate index for setting future increases in loan limits?

A.1. The National Association of Home Builders recommends that future FHA Mortgage Loan Limit increases be indexed to the U.S. Bureau of the Census Annual Construction Cost Index. This index is used to derive the annual value of general construction costs put into place and is a measure of the impact of inflation on construction costs. It is the best readily available index published on an annual basis.

American Federation of Labor and Congress of Industrial Organizations

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July 24, 2001

Honorable Jack Reed
Chairman
Subcommittee on Housing and Transportation
Senate Banking Committee
United States Senate
Washington, DC 20510-3903

Dear Senator Reed:

I am writing to express views regarding the FHA Multifamily Housing Mortgage Insurance Program.

The American union movement has historically supported a strong federal role in the production of decent and affordable housing. We are, therefore, concerned about any proposed changes in the FHA Multifamily Insurance Program that could further weaken the FHA and reduce production of needed multifamily housing.

We specifically question the propriety of the planned 60 percent increase in the mortgage insurance premium. This ill-conceived increase will only lead to higher costs, reduction of rental housing, and diminution of the FHA. We urge the Committee to call for a halt to any increase in the premium until its impact is fully and independently studied.

Despite years of economic growth, far too many Americans are being priced out of the housing market. Now is not a time to reduce production or promote higher rents. The FHA must be revitalized to address the nation's housing needs, and we strongly support the proposed increase in FHA multifamily loan limits.

Letter to Honorable Jack Reed
July 24, 2001
Page Two

The AFL-CIO looks forward to working with you in making the dream of decent and affordable housing a reality for all Americans.

Sincerely,

John J. Sweeney

John J. Sweeney
President

JJS:spt
opeiu #2, afl-cio

Statement of the
NATIONAL ASSOCIATION OF REALTORS®
on the FHA Multifamily Mortgage Program
Senate Subcommittee on Housing and Transportation
July 24, 2001

On behalf of the more than 760,000 members of the NATIONAL ASSOCIATION OF REALTORS®, and its affiliate the Institute of Real Estate Management, we are pleased to submit this written statement on HUD's FHA multifamily mortgage program. The NATIONAL ASSOCIATION OF REALTORS® represents a wide variety of real estate industry professionals including residential and commercial real estate development, mortgage banking, home building, property management, appraisals and syndication. The Institute of Real Estate Management is a professional association of more than 9,000 members engaged in the management and development of $800 billion worth of the nation's real estate assets. Our Associations have a long tradition of support for innovative and effective affordable housing programs and we work diligently with the Subcommittee and Congress to fashion housing policies that ensure Federal housing programs meet their mission and objectives responsibly and efficiently.

We commend the Subcommittee for its continuing efforts on behalf of American families who need and desire affordable housing opportunities. Even in these strong economic times where we have seen the greatest boom in homeownership rates, many working families are not able to find decent affordable housing.

FHA's multifamily loan programs provide insurance that assists both the private and public sectors to finance the construction, purchase and rehabilitation, or the refinancing of rental housing projects, condominiums, and cooperatives.

In light of the ever-growing crisis in housing affordability and ownership that is gripping our nation, these programs are especially important! Specifically, while our nation enjoys a record homeownership rate, the number of working families with worst case housing needs has increased sharply. The stock of rental units that are affordable and available is rapidly declining. And, home sales prices in certain market areas are rising far faster than the US average, resulting in an exacerbated affordability crisis.

The need for affordable housing is well documented in various research reports from a variety of institutions and interest groups, with one out of every seven American families having a critical housing need, including millions of working families. More than a quarter of low-income households must now spend over half their income on rent. Those families can't accumulate enough savings to buy a home of their own. Recent studies have determined that 13.7 million households, including 7.5 million renters, faced critical housing needs. Further, recent Census Bureau figures revealed that the number of moderate-income families facing a critical need for rental housing increased by 64 percent between 1997 and 1999, from 433,000 to 711,000 families. The problem is not only one of affordability but also one comprising inventory shortages in many areas of the country.

Very simply, families should not have to pay more than half their income for housing nor live in severely dilapidated homes. Our country is built on the foundation that a decent home in a suitable living environment is a basic tenet of American life. In light of the fundamental role that housing plays in the daily lives of Americans, the lack of affordable housing for working families -- and constructive solutions to address it -- justifies prominence on the national policy agenda.

Generally, a project is eligible for FHA multifamily mortgage insurance if the sponsors can demonstrate that there is a definite demand for the proposed housing in the market area, that the project will be economically self-sufficient, and that mortgage commitments from construction and permanent lenders have been received. Yet, the viability and usage of these programs has declined precipitously over the years.

The convergence of several factors altered the landscape of multifamily housing causing a scarcity of finance options and discouraging the participation of lenders in the multifamily market. These factors included the Tax Reform Act of 1986, changes in institutional lending mandated by FIRREA, and regulatory barriers limiting the program's effectiveness. In the 1980's, thrifts were the primary source of financing to multifamily projects dominating other sources. However, by the early 1990's, the thrift industry began a rapid downsizing for economic and regulatory reasons. The Tax Reform Act of 1986 (TRA) particularly undermined the value of real estate, especially multifamily housing. TRA eliminated much of the tax-favored status of rental housing and consequently the development and ownership of multifamily projects. TRA policy changes caused the supply of new multifamily housing to plummet and contributed to depressed values in properties held by banks, thus decreasing the ability of banks to continue making appropriate real estate and business loans.

Just as thrifts were directing their activities away from multifamily loans because of tighter risk-based capital rules, banks were also constrained in their ability to fund commercial real estate due to the same regulatory pressures. Because multifamily loans were in the highest risk category for capital purposes, banks avoided investing in multifamily properties. The increased regulatory pressure coupled with the difficulties in traditional lending markets affected not only acquisition and development financing but also permanent financing of income-producing properties.

The NATIONAL ASSOCIATION OF REALTORS® supports governmental solutions to stimulate the availability of private financing to spur new production and substantial rehabilitation of affordable rental housing, particularly in high cost areas of the country. We support the recently introduced S. 1163 the "FHA Multifamily Housing Mortgage Loan Limit Adjustment Act of 2001". By increasing the multifamily loan limits, FHA will stimulate not only new construction, but rehabilitation of existing infrastructure in many cities across the country, that have previously been out of reach of the FHA program. Only 748 FHA-insured multifamily new-construction or substantial-rehabilitation loans, producing just 127,409 units, were made nationally over the past four years. The result has been a significant and growing gap between the demand for and the supply of affordable rental housing. Increasing the FHA loan limits is a first step towards increasing production in many of our nation's cities.

However, the FHA multifamily programs face another, perhaps even more immediate, problem. The credit subsidy that allows these programs to operate is quickly being depleted. The appropriation needed to operate these programs is for a loan loss reserve required by the Credit Reform Act. The funds available for the loan loss reserve will soon be committed which will mean that FHA can no longer insure mortgages under these programs. Those apartment projects currently in processing for insurance will thus not be built or their construction will be delayed until FY 2002 – assuming new funds are made available even then.

It is important to note that last year FHA multifamily programs ceased operations in July, causing a backlog of projects. On October 1st, properties pending FHA insurance from FY01 used up much of the funding for FY02. Congress appropriated an additional $40 million as an emergency supplemental, however the Bush Administration is unwilling to accept these funds. This $40 million will provide for the new construction or substantial rehabilitation of over 17,000 units of rental housing with a mortgage amount of over $1.3 billion. Without these funds, these projects will not be built and developers who have invested hundreds of thousands of dollars in up-front costs for land options, plans and specifications and other pre-development costs will lose those investments. In addition, this opportunity to provide an immediate economic stimulus and produce thousands of construction jobs will be lost. We urge Congress to work with the Department of Housing and Urban Development, to release this money to be used for its appropriated purpose, and help to meet the critical demands for rental housing.

We are very disappointed in the recent conference action that removed $40 million from the FY01 Supplemental Appropriations bill. Providing additional funding for this program is crucial to the development of affordable housing. Both the House and Senate have approved a $40 million appropriation **twice** now. And yet, the program will not receive any additional funding. We urge the Committee to work with HUD and the industry to identify a way to restart this program this fiscal year.

We also oppose the premium increases, which HUD will implement in early August. These fees will place an unnecessary burden on developers, and may dissuade them from producing this much-needed housing. If investors chose to go forward with the project, the costs of the increased premium will likely be passed on to renting families. Rather than increase the premiums, we encourage Congress and the Administration to review the formulas currently used to assess risk associated with the programs in the GI/SRI fund. We believe the current assumptions are incorrect and we are strongly urging HUD to revise these assumptions and apply them to the programs as soon as possible.

The current crisis in affordable housing demands the use of FHA programs to stimulate affordable housing production. In recent years, funding for the credit subsidy has been underestimated, while the nation's affordable housing needs have grown. We urge Congress to increase the FY 2002 credit subsidy request above the Administration's proposal of $15 million to ensure that FHA multifamily programs remain operational and functional. The marketplace has been unable to respond to the housing needs of many of our nation's families because of imbalances in funding and program interruptions stemming from lax budgetary decisions. Congressional action is needed to increase production and rehabilitation and meet demand. Many developers and housing advocates are ready to respond to the housing needs in their area. But each year, as the credit subsidy expires, these projects remain unfunded. We cannot afford to lose any opportunity for affordable housing production.

Despite our growing economy, finding affordable housing is a burden for many working families. NAR is extremely sensitive to this significant problem and we are intimately engaged in identifying viable solutions to our nation's affordable housing crisis. NAR is a founding member of the Coalition for Affordable Rental Housing to develop sound solutions, and we are working with the Millennial Housing Commission to promote ideas and recommendations to address affordable housing. NAR is pleased to submit for the record our document, "Stimulating Affordable Housing Opportunities", with this statement. We look forward to working with Congress, the Administration, and housing organizations nationwide to collaboratively and cooperatively create affordable housing opportunities for all of our nation's families. Thank you for providing us the opportunity to provide this statement on behalf of the NATIONAL ASSOCIATION OF REALTORS®.

NATIONAL ASSOCIATION OF REALTORS®
The Voice for Real Estate®

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STIMULATING AFFORDABLE HOUSING OPPORTUNITIES

June 2001

NATIONAL ASSOCIATION OF REALTORS®

Richard A. Mendenhall, President

Martin Edwards, Jr., President-Elect

Terrence M. McDermott, Executive Vice President

Lee L. Verstandig, Senior Vice President, Government Affairs

EXECUTIVE SUMMARY

The NATIONAL ASSOCIATION OF REALTORS® has consistently maintained that homeownership serves as a cornerstone of our democratic system of government and that homeownership continues to be a strong personal and social priority in the United States.

The NATIONAL ASSOCIATION OF REALTORS® has equally and forcefully maintained that rental housing has an immediate and beneficial effect on the prosperity of a community, providing a range of housing options that not only attract top employers but also generate local taxes, fees, and income that benefits the local economy.

Clearly, housing plays a fundamental role in the daily lives of Americans. However, despite being the best housed country in the world, our nation is experiencing a growing crisis in housing affordability and ownership that, left unaddressed, stands to threaten the future economic and social success for American families and their children.

This document lays out constructive ideas and recommendations to encourage affordable housing opportunities and increase the supply of affordable housing nationwide. Our recommendations encompass the following:

Closing the Homeownership Gap

- *Support and promote administrative relaxation of HUD policy regarding owner-occupancy ratios under the FHA condominium insurance program*
- *Support and promote legislation modifying the FHA adjustable-rate mortgage product to accommodate a hybrid FHA ARM and eliminate the loan cap on ARMs*
- *Support the creation of public private partnerships to rpomote the Section 8 homeownership program*

Creating Underwriting/Financing Incentives

- *Lengthen the amortization period for FHA mortgage loans beyond the existing 30-year term*
- *Make permanent the FHA downpayment simplification calculation*
- *Support legislation that provides for detailed disclosure of mortgage lending credit scores*
- *Encourage the use of rental payment history as credit information to improve access to credit*

Stimulating Affordable Rental Housing

- *Eliminate disincentives to tax credit programs*
- *Increase the FHA multifamily loan limits*
- *Eliminate the disincentives to owner participation in the Section 8 program*
- *Support legislation that provides adequate federal funding for for the assessment, cleanup and redevlopment of brownfields sites*
- *Support and promote legislation that expands designations and broadens resources for the Enterprise Zone Enterprise Community Initiative*

Improving Access to Housing

- *Enhance the Fair Housing Initiatives Program and the Fair Housing Assistance Program*
- *Support legislation strengthening Title III of the Americans with Disabilities Act*

Enhancing the Mission and Delivery of Existing Federal Housing Programs

- *Remove the disincentives and barriers that limit the mission and objectives of critical housing programs.*

As the Millennial Housing Commission undertakes the challenging task of identifying solutions to our nation's affordable housing crisis, the NATIONAL ASSOCIATION OF REALTORS® stands ready to work with the Commission to fulfill its mission in this important area.

NATIONAL ASSOCIATION OF REALTORS®
Government Affairs Division
June 2001

INTRODUCTION

The NATIONAL ASSOCIATION OF REALTORS® represents a wide variety of housing industry professionals committed to the development and preservation of the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective Federal housing programs and we work diligently with Congress and the Executive Branch to fashion housing policies that ensure Federal housing programs meet their mission responsibly and efficiently.

Very simply, Federal support of housing is a critical element in meeting the goals of decent housing and homeownership opportunities for all. However, these goals will only be achieved if there is mutual support and cooperation from all concerned groups, including state and local governments, private enterprises, charitable organizations, REALTORS®, builders and those involved in mortgage finance.

Housing has always been and continues to be one of the highest personal and social priorities in America. This national expression fostered landmark legislation in 1949 insuring "decent and suitable" housing for all Americans that has been directed to two basic but primary goals over the years: providing an adequate supply of affordable rental housing and promoting widespread homeownership opportunities.

Despite these ideals and our nation's unprecedented economic prosperity, our nation is experiencing a growing crisis in housing affordability and ownership. More specifically, while the country is enjoying a record homeownership rate, the homeownership rate for ethnic Americans continues to lag below 50 percent. The number of working families with worst case housing needs has increased sharply. The stock of rental units that are affordable and available is rapidly declining.

The need for affordable housing and homeownership is well documented in various research reports from a variety of institutions and interest groups. The NATIONAL ASSOCIATION OF REALTORS® commends the Millennial Housing Commission for undertaking the awesome task of evaluating the nation's efforts to support decent housing for all Americans and make recommendations about housing policy for the United States. The NATIONAL ASSOCIATION OF REALTORS® welcomes this opportunity to share our views and observations regarding housing policy and programs and we stand ready to work with the Commission to fulfill its mission in this important area.

Closing the Homeownership Gap

Fueled by the nation's strong economic prosperity, the national homeownership rate reached a new annual high of 67.7 percent in 2000 and continues to climb across all geographic regions, age groups and ethnic groups. All-time high rates were set for minorities, at 48.2 percent; Hispanics, at 46.7 percent; central city residents, at 51.9 percent; households headed by females, at 53.3 percent; and married couples younger than 35, at 61 percent. However, despite these important gains, persistent homeownership disparities between whites and minorities narrowed slightly. The NATIONAL ASSOCIATION OF REALTORS® believes continued efforts must be undertaken to provide opportunities to underserved populations to achieve the dream of homeownership. With the introduction of low-downpayment products, flexible underwriting standards, and improved risk assessment tools, the mechanisms exist to close our nation's homeownership gap. We recommend the following to complement the innovation and outreach undertaken by the real estate industry:

Support and promote administrative relaxation of HUD policy regarding owner-occupancy ratios under the FHA condominium insurance program. Currently, HUD requires that condominium developments be at least 51 percent owner-occupied before individual units can be deemed eligible for FHA-insured loans. The policy is restrictive because it limits sales and homeownership opportunities, particularly in market areas comprised of significant condominium developments and first-time homebuyers. It is important to note that the condo market has matured since adoption of the 51 percent rule. Liquidity risk has dramatically declined as the market has matured which, in turn, has fueled the growth and popularity of condo ownership as a viable homeownership tool. In support of this, our research has determined that nationwide sales of previously owned condominiums and cooperatives climbed to a record level of 763,000 units in the three months of 2001, up 5.8 percent from 721,000 during the previous quarter.

Support and promote legislation modifying the FHA adjustable-rate mortgage product to accommodate a hybrid FHA ARM and eliminate the loan cap on the aggregate number of ARMs that FHA may insure annually. The FHA adjustable-rate mortgage experience has demonstrated it to be a viable and sound product that has evolved into a standard home financing tool and patterned by other mortgage providers. A "hybrid" ARM provides a mix of adjustable-rate and fixed-rate features, providing a useful avenue of homeownership especially for first-time homebuyers. The hybrid ARM carries a fixed rate for an initial period of time -- customarily three to seven years -- followed by rate adjustments once a year for the balance of the 30-year loan term.

Support the creation of public/private partnerships promoting outreach encompassing the Section 8 homeownership program and eliminate the disincentives associated with Public Housing Agencies (PHAs) participation. HUD now permits tenant-based Section 8 holders to use their voucher payment towards the purchase of a home. This new initiative has the potential of broadening the range of affordable housing opportunities and providing a step up the housing ladder to homeownership. Yet, the program has not received widespread recognition and very few PHAs that administer the Section 8 tenant-based program have opted to offer the homeownership program to their residents.

Creating Underwriting/Financing Incentives

Mortgage financing is readily available in the United States due principally to a competitive marketplace, stable home values and a thriving capital market infrastructure. Nevertheless, some forms of homeownership financing are not adequately available in all markets. Moreover, mortgage financing is not always adequately available in certain neighborhoods or areas, particularly those communities that are experiencing an economic downturn.. To facilitate affordable housing and generate new homeownership opportunities, the continuous availability of mortgage financing is a critical ingredient.

The NATIONAL ASSOCIATION OF REALTORS® has continuously maintained that the cost, terms, and availability of mortgage financing are of critical importance to the level of homeownership. While our mortgage finance system provides a steady and reliable source of market-rate mortgage money, transaction costs linked to home purchase and financing remain high. For many potential homebuyers, the lack of cash available to accumulate the required downpayment and closing costs is a key impediment to purchasing a home. Other households do not have sufficient available income to make the monthly payments on mortgages financed at market interest rates for standard loan terms. To address these barriers, the NATIONAL ASSOCIATION OF REALTORS® recommends the following:

Lengthen the amortization period for FHA mortgage loans beyond the existing 30-year term. Currently, the term of the mortgage insured under the FHA single-family mortgage insurance program cannot exceed thirty years. Extending the life of the loan above thirty years would reduce the monthly mortgage payment, allowing more households to qualify for a mortgage and, hence, increase homeownership opportunities. Research conducted by the NATIONAL ASSOCIATION OF REALTORS® has determined that approximately 52 percent of American households currently can qualify to purchase the U.S. median priced home of $139,000 with a 30-year mortgage. This amounts to approximately 54.7 million households. Extending the life of the loan to 35 years would enable almost 54 percent of American households to qualify for a $139,000 home, representing an increase of 1.4 million households. And, extending the life of the loan to 40 years would permit almost 55 percent of households to qualify for homeownership, an increase of 2.6 million households above current levels.

Make permanent the FHA downpayment simplification calculation. In 1996 Congress approved legislation simplifying the FHA downpayment calculation as a two-year pilot program in Alaska and Hawaii. Simplifying the calculation made it easier for FHA borrowers to understand the downpayment process and it made the downpayment on an FHA loan more affordable. Recognizing the benefits resulting from the simplification process, in 1998 Congress extended the calculation another two years and made it applicable nationwide. In 2000 Congress extended the simplification calculation 27-months, to December 31, 2002. The NATIONAL ASSOCIATION OF REALTORS® believes that the simplified downpayment calculation should be made a permanent feature of the FHA single-family mortgage insurance program.

Support legislation that provides for detailed disclosure of mortgage lending credit scores including meaningful explanatory data. Consumers need to be fully informed as they make a decision to accept a mortgage offered by a lender. The disclosure should permit a borrower to evaluate the situation if denied credit, or if the rate or credit terms do not meet the borrower's criteria. Further, consumers should be empowered to ask the lender if a credit scoring system was used, what characters or factors are used in that system, and the best ways to improve or better the mortgage application.

Encourage the use of rental payment history as credit information to improve access to credit in the homebuying process. With the movement of major lenders to automated processing to streamline the availability of mortgage credit, credit scoring is an emerging issue that will significantly influence mortgage credit availability and definitions of creditworthiness. Consequently, the types of supporting information to be collected and used for developing appropriate scoring models and predicting borrower creditworthiness is a key factor. If properly utilized and framed with appropriate consumer safeguards, automated underwriting has the potential of making mortgage credit more widely available at lower costs. However, the challenge is to ensure that automated underwriting does not perpetuate racial disparities in the loan process and to identify loan repayment predictor mechanisms that do not disadvantage special populations. Tracking rental payment history may serve as a useful predictor in determining the creditworthiness of a borrower and, hence, their acceptance for mortgage credit. With the FHA single-family mortgage program stronger than ever, we believe the timing is appropriate for FHA to return to its mission as mortgage finance innovator and take the lead and implement this recommendation.

Stimulating Affordable Rental Housing

The need for affordable housing is well documented in various research reports from a variety of institutions and interest groups, with one out of every seven American families having a critical housing need, including millions of working families. The problem is not only one of affordability but also one comprising inventory shortages in many areas of the country. Very simply, families should not have to pay more than half their income for housing nor live in severely dilapidated homes. Our country is built on the foundation that a decent home in a suitable living environment is a basic tenet of American life.

The NATIONAL ASSOCIATION OF REALTORS® believes that federal mortgage finance and assisted-housing programs that have proven records for producing and preserving affordable housing must not only be preserved but strengthened and provided with significant additional resources. Moreover, to encourage homeownership opportunities for all Americans and increase the supply of affordable housing nationwide, necessary initiatives, programs and policies must be developed and supported by key policymakers.

Eliminate disincentives to tax credit programs to stimulate broader and increased affordable housing opportunities. Tax credits have served a useful purpose by providing equity investments for affordable rental housing. They have served as enormously successful tools in not only producing affordable housing but also in attracting owners and investors to finance the construction and rehabilitation of affordable housing. Very simply, tax credits provide investors a dollar-for-dollar reduction in their federal tax liability in exchange for providing financing to develop affordable housing. One such program, the Low Income Housing Tax Credit (LIHTC), has a tremendous record of success for producing affordable housing. Yet, its reach is restricted by guidelines that limit the income levels of tenants and rent levels of apartment units. Further, participation by owners and investors is limited because of the numerous administrative rules and regulations, lengthy application process and burdensome compliance forms that must be submitted and completed.

Increase the FHA multifamily loan limits. Despite our nation's economic growth and prosperity, millions of working American families are facing a housing affordability crisis. This is exacerbated by the continuing decline of the nation's affordable housing stock. The increased demand for housing coupled with diminished supply is straining housing units nationwide, thrusting policymakers to devise useful solutions and approaches to stimulate new affordable housing opportunities. Absent new and immediate solutions to the problem, a more feasible and direct approach to stimulate the availability of affordable rental housing entails modifications to existing federal programs to spur new production and substantial rehabilitation. Increasing the FHA multifamily loan limits by 25 percent represents a plausible solution to the affordable housing crisis. The loan limits for FHA multifamily insurance have not been revised upward since 1992, contributing significantly to FHA's inability to be a viable source for rental housing.

Eliminate the disincentives to owner participation in the Section 8 voucher program. NAR and its affiliate, The Institute of Real Estate Management, is involved in the ownership and management of Section 8 properties in recognition that affordable rental housing is the first step on the housing ladder for many Americans. The Section 8 program provides a government subsidy, or voucher, to bridge the gap between a low-income tenant's income and the cost of providing housing, enabling recipients to choose where they want to live. Because of the dwindling supply of affordable housing, each year thousands of vouchers are returned, unused, to HUD because the families provided the assistance were simply unable to locate affordable housing. A principal reason for the decreasing supply of available and affordable rental housing is owners' increasing unwillingness to accept housing vouchers due to the regulatory burdens associated with the program. Owner participation customarily entails sacrificing private property rights and complying with burdensome regulations and procedures that compromise the performance and viability of a property. These disincentives include entering into housing assistance payment contracts; amendments of landlord leases; and compliance with regulations not normally attendant in conventional housing practices.

Support legislation that provides adequate federal funding for the assessment, cleanup and redevelopment of the nation's brownfield sites and the elimination of local liability. Redeveloping brownfields sites poses significant benefits to communities, particularly urban areas where most brownfields are located. Turning these areas into viable community uses enhances local tax revenues, creates jobs and stimulates affordable housing and investment projects benefiting the people who reside in the affected communities.

Support and promote legislation that expands designations and broadens resources encompassing HUD's urban Enterprise Zones and Enterprise Community Initiative. The Enterprise Zone/Enterprise Community (EZ/EC) Initiative facilitates the conversion of vacant lots and abandoned buildings to new business complexes and affordable housing, providing housing and employment opportunities and strengthening support services to benefit local residents and their communities. NAR supports initiatives that foster job growth and retention matched with homeownership opportunities enhancing community and economic revitalization and the nation's continuing prosperity.

Improving Access to Housing

As our nation's laws and culture have changed to recognize and provide the right of all people to freely choose where they will live, so too has the commitment and practices of the private sector housing industry changed to open the doors to homeownership opportunities for underserved and unserved populations. Yet, discriminatory practices -- real and perceived -- continue to stubbornly persist mandating a stronger commitment and effort by all participants in the housing industry. In many instances racial and ethnic minorities, elderly citizens, people with disabilities and families with children have been denied the opportunity to realize the American dream of homeownership.

Very simply, the NATIONAL ASSOCIATION OF REALTORS® is steadfast in its commitment to ensuring equal opportunity in housing and the right of all people to choose freely where they will live without the constraint of prejudice or discrimination. While market pressures and honorable initiatives are resulting in increased access to housing opportunities, we recognize the importance of continuously encouraging the private sector to responsibly join federal, state and local entities in ending housing discrimination. To meet this objective, as "the voice for real estate" we readily accept and wholeheartedly welcome our role as leaders in the achievement and promotion of fair and accessible housing and as an advocate for fair and workable policies and regulations that assure families of their right to choose where to live.

Enhance the Fair Housing Initiatives Program (FHIP) and the Fair Housing Assistance Program (FHAP) to encourage combined education and enforcement efforts, increased partnership between fair housing organizations and housing industry groups, and to support innovative solutions such as self-testing. NAR takes seriously its responsibility to educate its members regarding fair housing and has developed award-winning training programs widely utilized throughout the nation. Because of our education and partnership successes, NAR believes it is appropriate to measure the relative effectiveness of various approaches to ending housing discrimination and to ascertain ways to link enforcement and education efforts to increase their impact. NAR believes that the FHIP/FHAP should become more flexible to support innovative and collaborative efforts between the housing industry and private fair housing organizations.

Support legislation strengthening Title III of the Americans with Disabilities Act (ADA) by providing businesses with notices of non-compliance affording owners the opportunity to expend resources making their properties *more accessible to the disabled.* Currently, the ADA does not contain a notice requirement for violations of the ADA exposing business owners to face costly litigation for non-compliance. While the public accommodations provisions in Title III of the ADA do not allow plaintiffs to collect damages for violations of any of its access standards, it does permit attorneys to collect their fees. This has encouraged a number of attorneys to sue businesses over infractions that are inexpensive to remedy but for which the businesses must pay costly plaintiffs' attorneys' fees and expenses. Amending the ADA to include a notice requirement for violations of the ADA before a court could assume jurisdiction over the dispute would permit businesses to bring properties into compliance without facing costly and unnecessary litigation.

Enhancing the Mission and Delivery of Existing Federal Housing Programs

Government mortgage programs represent the most important source of homeownership for many American families. The Federal Housing Administration's (FHA) single-family mortgage insurance program is the only mortgage insurance program that provides complete geographic coverage of the United States; the Department of Veterans Affairs (DVA) home loan guaranty program provides an entitlement homeownership benefit to men and women veteran and service personnel as appreciation for their service to their country; and the Rural Housing Service's (RHS) loan and guarantee programs offer financing, homeownership and development opportunities to rural families and communities to ensure the availability and accessibility of credit and housing assistance.

Federally-assisted housing programs facilitate the financing needed to deliver and preserve affordable multifamily rental housing opportunities. Through the FHA and RHS, a variety of multifamily programs have enabled individuals and families to attain housing opportunities while helping developers produce multifamily housing.

NAR strongly supports, and is an active participant in, government mortgage and federally-assisted housing programs and believes their continued operation is necessary to provide homeownership and rental housing opportunities. While these programs have been beneficial over the years in addressing the particular housing needs of program recipients, their ability to keep pace with ever-growing demand has been constrained due to outdated or outmoded policies and procedures hampering their mission and objectives. To ensure their continued viability and goal of providing safe, decent and affordable housing to American families, NAR recommends the following:

VA Home Loan Guaranty Program

Support legislation increasing and indexing the veterans guaranty amount to ensure VA mortgages maintain pace with home sales prices. Currently, the VA guaranty amount is $50,750 allowing veterans to purchase a home loan up to a maximum of $203,000. The VA guaranty was last increased in 1994 and currently lags the FHA high-cost mortgage limit of $239,250 and the conforming Fannie/Freddie loan amount of $275,000.

Support legislation re-establishing the VA adjustable-rate mortgage (ARM) program and offer a hybrid ARM. The VA ARM was established in 1992 as a three-year pilot program. The program expired in 1995 because of budgetary concerns presented by the Congressional Budget Office despite widespread appeal within the veteran community and real estate industry. Creation of the VA ARM program helped to modernize the VA home loan guaranty program and make the VA mortgage program attractive and competitive with other mortgage products.

Eliminate the two-year work requirement for VA home loan purchasers. One obstacle to achieving homeownership more rapidly for veteran borrowers is the requirement that veterans have two years of stable employment history in order to be eligible for a VA loan guarantee. Currently, many private lenders use more flexible underwriting standards, including demonstration of current employment. Additionally, many self-employed veterans are unable to qualify for a VA loan guarantee because of the two-year stable employment restriction. Elimination of this underwriting requirement, accompanied by verification of current employment, would enable more veterans to achieve homeownership sooner from their discharge dates.

Make reservists' eligibility a permanent feature of the VA home loan guaranty program. In 2000 reservists' participation in the home loan program was extended by Congress through September 30, 2007. Their eligibility started in 1992 as a pilot program and has been re-extended numerous times by Congress. Reservists' participation has resulted in tens of thousands of dedicated National Guard and Reserve members fulfilling their dreams of homeownership. Their participation has helped to reinvigorate the program and not only provided financial stability to the VA program but also contributed a lower default rate than most other program participants.

Utilize public private partnerships in the management and marketing of VA's property management operations. The DVA is considering alternatives to its existing Property Management operations to improve efficiency and increase prompt delivery of properties to the sales marketplace. NAR encourages the DVA to utilize the services and involvement of local real estate professionals and to utilize the services of more than one entity in a particular geographic region to limit the potential for monopoly and marketplace disadvantages. Further, NAR recommends that all properties be listed with real estate professionals participating in local and regional Multiple Listing Services, in compliance with local MLS rules and guidelines, as an effective method of ensuring the widest possible access to properties by the general public.

Expand the VA appraiser fee panels to include more appraisers particularly in markets where there is an acute shortage of VA appraisers. Current law requires that appraisers be assigned from the DVA's list of appraisers on a rotational basis. In some areas the rotation system is causing imbalances in the number of appraisers in differing regions of the country and are contributing to lengthy periods of time to complete VA-approved appraisals. This longer processing period either discourages a seller from contracting with a veteran or precludes a veteran from finalizing his or her purchase.

FHA Multifamily Mortgage Insurance Programs

Reform credit subsidy and commit increased resources to FHA multifamily programs to ensure their uninterrupted operation. Beginning 1992 the Federal Credit Reform Act significantly altered the budgetary treatment of credit programs including loan guarantee programs. Under the Credit Reform Act FHA is required to estimate its net costs to the government of insuring new mortgage loans in addition to estimating the losses from anticipated defaults on loans in its current portfolio. The Act requires that federal agencies have budget authority to cover a program's cost to the government in advance, before new loan guarantee commitments are made. As a result agencies must determine needed credit subsidy on a program-by-program basis, based on whether the programs represent a cost to the government, break even, or make a profit. Consequently, new multifamily loan volume that FHA may insure is limited by the amount of budget authority FHA is provided for credit subsidy.

For the second year in a row, the credit subsidy process has contributed to HUD halting insurance activity for multifamily mortgages principally because of a depletion of subsidy funding for FHA's multifamily programs. In FY2001 Congress appropriated only $101 million which was exhausted by April 19. In FY2000 HUD announced on July17, 2000 that all credit subsidy was committed and that firm commitments would be conditioned upon the availability of credit subsidy. Furthermore, an emergency supplemental appropriation of $40 million approved by Congress December 2000 is not being made available for use. The effect of the shutdowns is jeopardizing the production of thousands of critical affordable housing units. Without these important funds many projects will not be built and developers who have invested significant dollars in up-front costs for land options, plans and specifications and other pre-development costs will lose those investments.

HUD's Property Disposition Program
Remove the disincentives of marketing properties through HUD's Management and Marketing Sales Contract program to improve the availability of HUD real estate-owned properties and reduce government inventory and program costs. Currently, HUD disposes of its foreclosed inventory stock through private management and marketing companies who are under contract to the Department for all aspects of property disposition. Because the contractors operate under incentive-based criteria to obtain the best price for sales within the quickest timeframe to maintain low costs to the government, this process does not always result in timely and correct information being made available to the public regarding properties for acquisition. NAR has consistently maintained that local REALTORS® must be involved in the sale of HUD-owned properties to facilitate the availability of information about and marketing of affected properties. We also encourage the Department to require the management and marketing contractors to feature regular training and education sessions on behalf of the local real estate community to increase broker participation and prospective purchasers

Modify HUD policy permitting licensed real estate brokers to participate under the Teacher Next Door/Officer Next Door (TND/OND) programs. Currently, homebuyers are required to utilize a licensed real estate broker when bidding on a HUD-owned property under the Department's management and marketing program. However, under the TND/OND program, prospective purchasers' use of a broker when bidding on a property is significantly discouraged because, under HUD policy, the broker's fee is subtracted from the purchaser's discount. The result is that meaningful prospective home purchasers under TND/OND are unfamiliar with the home purchase process and left vulnerable to incidents of fraud and abuse.

Rural Housing Programs
Commit increased resources to the Section 502 direct loan program. The Section 502 direct loan program is the basic RHS individual homeownership loan program providing funding assistance to states for loans for very-low, low-, and moderate-income homebuyers. While the program has been instrumental in addressing rural housing needs, appropriations have not kept pace with the growing gap between the number of decent, affordable housing units in rural communities and the need for those units.

Permit borrowers to finance into their mortgages the full two percent guarantee fee under the Section 502 guaranteed loan program. The Section 502 guaranteed loan program was established in 1991 to guarantee home loans made by private lenders for moderate-income rural borrowers who might not be able to obtain credit otherwise. The program permits borrowers to obtain loans for 100 percent of the appraised value of a house, thereby eliminating the downpayment barrier that prevents many rural families from becoming homeowners. Last year Congress approved a provision increasing the guarantee fee from one to two percent of the principal amount of the loan. Currently, RHS does not permit borrowers to finance the fee into their loan. Modifying this policy will ease rural borrower's financial hardships associated with the fee increase.